# DOCKET

# SUPREME COURT
OF THE UNITED STATES

No. 12-1408
Title: United States, Petitioner
v.
Quality Stores, Inc., et al.
Docketed: May 31, 2013
Linked with 12A921
Lower Ct: United States Court of Appeals for the Sixth Circuit
Case Nos.: (10-1563)
Decision Date: September 7, 2012
Rehearing Denied: January 4, 2013
**Questions Presented**

| ~~~Date~~~ | ~~~~~~~Proceedings and Orders~~~~~~~~~~~~~~~~~~~~ |
|---|---|
| Mar 25 2013 | Application (12A921) to extend the time to file a petition for a writ of certiorari from April 4, 2013 to May 4, 2013, submitted to The Chief Justice. (Justice Kagan is recused.) |
| Mar 25 2013 | Application (12A921) granted by The Chief Justice extending the time to file until May 3, 2013. |
| Apr 22 2013 | Application (12A921) to extend further the time to file a petition for a writ of certiorari from May 3, 2013 to May 31, 2013, submitted to The Chief Justice. |
| Apr 22 2013 | Application (12A921) granted by The Chief Justice extending the time to file until May 31, 2013. |
| May 31 2013 | Petition for a writ of certiorari filed. (Response due July 1, 2013) |
| Jun 7 2013 | Order extending time to file response to petition to and including July 31, 2013. |
| Jul 30 2013 | Brief of respondents Quality Stores, Inc., et al. in opposition filed. |
| Aug 14 2013 | DISTRIBUTED for Conference of September 30, 2013. |
| Aug 15 2013 | Reply of petitioner United States filed. (Distributed) |
| Oct 1 2013 | Petition GRANTED. Justice Kagan took no part in the consideration or decision of this petition. |
| Nov 4 2013 | SET FOR ARGUMENT ON Tuesday, January 14, 2014. |
| Nov 8 2013 | Joint appendix filed. (Statement of costs filed.) |
| Nov 8 2013 | Brief of petitioner United States filed. |
| Nov 15 2013 | Record from the U.S.C.A. 6th Circuit is electronic and located on PACER. |
| Nov 15 2013 | Brief amicus curiae of Professor Kristin E. Hickman in support of neither party filed. |
| Nov 21 2013 | CIRCULATED. |

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|---|---|
| Dec 6 2013 | Brief of respondents Quality Stores, Inc., et al. filed. |
| Dec 13 2013 | Brief amicus curiae of American Benefits Council filed. (Distributed) |
| Dec 13 2013 | Brief amicus curiae of American Payroll Association filed. (Distributed) |
| Dec 13 2013 | Brief amicus curiae of ERISA Industry Committee filed. (Distributed) |
| Dec 31 2013 | Reply of petitioner United States filed. (Distributed) |
| Jan 14 2014 | Argued. For petitioner: Eric J. Feigin, Assistant to the Solicitor General, Department of Justice, Washington, D. C. For respondents: Robert S. Hertzberg, Southfield, Mich. |
| Mar 25 2014 | Judgment REVERSED and case REMANDED. Kennedy, J., delivered the opinion of the Court, in which all other Members joined, except Kagan, J., who took no part in the consideration or decision of the case. |
| Apr 28 2014 | JUDGMENT ISSUED. |

# PETITION FOR WRIT OF CERTIORARI

12-1408

No.

# In the Supreme Court of the United States

UNITED STATES OF AMERICA, PETITIONER

*v.*

QUALITY STORES, INC., ET AL.

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT*

## PETITION FOR A WRIT OF CERTIORARI


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## QUESTION PRESENTED

Whether severance payments made to employees whose employment was involuntarily terminated are taxable under the Federal Insurance Contributions Act, 26 U.S.C. 3101 *et seq.*

## TABLE OF CONTENTS


Page

Opinions below ..... 1
Jurisdiction ..... 1
Statutory and regulatory provisions involved ..... 2
Statement ..... 2
Reasons for granting the petition ..... 7
A. The decision below is incorrect ..... 9
B. The decision below conflicts with decisions of this Court and other courts of appeals ..... 20
C. The question presented is recurring and exceptionally important ..... 25
Conclusion ..... 26
Appendix A — Court of appeals opinion (Sept. 7, 2012) ..... 1a
Appendix B — Court of appeals order denying rehearing (Jan. 4, 2013) ..... 31a
Appendix C — District court opinion (Feb. 23, 2010) ..... 33a
Appendix D — Bankruptcy court opinion (Mar. 3, 2008) ..... 55a
Appendix E — Bankruptcy court order regarding reconsideration (Aug. 29, 2008) ..... 78a
Appendix F — Bankruptcy court final judgment (Nov. 25, 2008) ..... 81a
Appendix G — Statutory and regulatory provisions ..... 84a


## TABLE OF AUTHORITIES

Cases:


*Abrahamsen* v. *United States*, 228 F.3d 1360 (Fed. Cir. 2000), cert. denied, 532 U.S. 957 (2001) ..... 23, 24
*Appoloni* v. *United States*, 450 F.3d 185 (6th Cir. 2006), cert. denied, 549 U.S. 1165 (2007) ..... 23, 24
*Bingler* v. *Johnson*, 394 U.S. 741 (1969) ..... 11
*CSX Corp.* v. *United States*:
518 F.3d 1328 (Fed. Cir. 2008) ..... *passim*
52 Fed. Cl. 208 (2002) ..... 5

Cases—Continued: Page

*Coffy* v. *Republic Steel Corp.*, 447 U.S. 191 (1980) ..... 22
*Hemelt* v. *United States*, 122 F.3d 204 (4th Cir. 1997) ..... 10
*Mayo Found. for Med. Educ. & Research* v. *United States*, 131 S. Ct. 704 (2011) ..... 9, 11
*North Dakota State Univ.* v. *United States*, 255 F.3d 599 (8th Cir. 2001) ..... 23
*Otte* v. *United States*, 419 U.S. 43 (1974) ..... 21, 22
*Rivera* v. *Baker West, Inc.*, 430 F.3d 1253 (9th Cir. 2005) ..... 10
*Rowan Cos., Inc.* v. *United States*, 452 U.S. 247 (1981) ..... 6, 15
*Social Sec. Bd.* v. *Nierotko*, 327 U.S. 358 (1946) ... 8, 9, 20, 21
*United States* v. *Silk*, 331 U.S. 704 (1947) ..... 11
*University of Pittsburgh* v. *United States*, 507 F.3d 165 (3d Cir. 2007) ..... 22, 23

Statutes and regulation:

Internal Revenue Code (26 U.S.C.):
Federal Insurance Contributions Act, 26 U.S.C. 3101 *et seq.* ..... 2
26 U.S.C. 3101(a) ..... 2, 9
26 U.S.C. 3101(b) ..... 2, 9
26 U.S.C. 3111(a) ..... 2, 9
26 U.S.C. 3111(b) ..... 2, 9
26 U.S.C. 3121(a) (2006 & Supp. V 2011) ..... 2, 7, 9, 14
26 U.S.C. 3121(a)(1)-(23) (2006 & Supp. V 2011) ..... 11
26 U.S.C. 3121(b) (2006 & Supp. V 2011) ..... 2, 7, 10, 14, 21, 22

Statutes and regulation—Continued: Page

26 U.S.C. 3121(b)(1)-(21) (2006 & Supp. V 2011) ..... 11
26 U.S.C. 1426(a)(4) (1946) ..... 13
26 U.S.C. 3402(*o*) ..... *passim*
26 U.S.C. 3402(*o*)(1) ..... 7, 15
26 U.S.C. 3402(*o*)(1)(A) ..... 14, 16
26 U.S.C. 3402(*o*)(2) ..... 8
26 U.S.C. 3402(*o*)(2)(A) ..... *passim*
Social Security Act Amendments of 1950, ch. 809, 64 Stat. 477 ..... 13
42 U.S.C. 401 *et seq.* ..... 25
20 C.F.R. 404.1001 ..... 25

Miscellaneous:

*Black's Law Dictionary* (9th ed. 2009) ..... 9
8 Oxford English Dictionary (1st ed. 1933) ..... 9
Rev. Rul.:
56-249, 1956-1 C.B. 488 ..... 12, 16
58-128, 1958-1 C.B. 89 ..... 12, 13
59-227, 1959-2 C.B. 13 ..... 13
60-330, 1960-2 C.B. 46 ..... 13
65-251, 1965-2 C.B. 395 ..... 13
71-408, 1971-2 C.B. 340 ..... 13, 14
90-72, 1990-2 C.B. 211 ..... 14, 17
*Webster's Third New International Dictionary of the English Language* (1993) ..... 9

# In the Supreme Court of the United States

No.

UNITED STATES OF AMERICA, PETITIONER

*v.*

QUALITY STORES, INC., ET AL.

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT*

## PETITION FOR A WRIT OF CERTIORARI

The Solicitor General, on behalf of the United States, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

### OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-30a) is reported at 693 F.3d 605. The opinion of the district court (App., *infra*, 33a-54a) is reported at 424 B.R. 237. The opinion of the bankruptcy court (App., *infra*, 55a-77a) is reported at 383 B.R. 67.

### JURISDICTION

The judgment of the court of appeals was entered on September 7, 2012. A petition for rehearing was denied on January 4, 2013 (App., *infra*, 31a-32a). On March 25, 2013, the Chief Justice extended the time within which to file a petition for a writ of certiorari to and including May 3, 2013. On April 22, 2013, the Chief Justice fur-

ther extended the time to May 31, 2013. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

## STATUTORY AND REGULATORY PROVISIONS INVOLVED

Relevant statutory and regulatory provisions are reproduced in the appendix to this petition. App., *infra*, 84a-214a.

## STATEMENT

1. Social Security and Medicare benefits are financed through taxes collected under the Federal Insurance Contributions Act (FICA or the Act), 26 U.S.C. 3101 *et seq.* FICA taxes are imposed on both employers and employees, and both elements of the tax are imposed on all "wages" paid by an employer or received by an employee "with respect to employment." 26 U.S.C. 3101(a) and (b), 3111(a) and (b). FICA defines "wages" in relevant part as "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash." 26 U.S.C. 3121(a) (2006 & Supp. V 2011). The Act defines "employment" in turn as "any service, of whatever nature, performed * * * by an employee for the person employing him." 26 U.S.C. 3121(b) (2006 & Supp. V 2011).

Section 3402(*o*) of Title 26 deals with withholding of income tax and is entitled "[e]xtension of withholding to certain payments other than wages." 26 U.S.C. 3402(*o*). The provision states a "[g]eneral rule" that, for purposes of Chapter 24 of Title 26 (dealing with income-tax withholding) and certain related provisions, "any supplemental unemployment compensation benefit paid to an individual * * * shall be treated as if it were a payment of wages by an employer to an employee for a payroll period." The term "[s]upplemental unemployment compensation benefits" is defined to mean "amounts

which are paid to an employee, pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment (whether or not such separation is temporary), resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, but only to the extent such benefits are includible in the employee's gross income." 26 U.S.C. 3402(*o*)(2)(A).

2. In 2001, respondent Quality Stores, Inc. (Quality Stores) and several affiliated companies entered into bankruptcy proceedings. Both before and after their entry into bankruptcy, respondents terminated thousands of their employees. Those employees received severance payments from respondents pursuant to two separate plans. App., *infra*, 2a-3a. The question presented here is whether those severance payments are taxable as "wages" under FICA.

a. Under the terms of the pre-petition severance plan, any employee who was terminated for general business reasons (like the closing of a store or a plant) received severance pay based on his job grade and management level in the organization. The President and Chief Executive Officer received 18 months of severance pay; senior management executives received 12 months of severance pay; and other managers and employees received one week of severance pay for each full year of service. The amount of the severance pay was equal to the employee's regular salary for the covered period, and respondents made the severance payments on their normal payroll schedule. Under the pre-petition plan, salaried employees received an average of 11.4 weeks of severance pay, while hourly employees received an average of 4.2 weeks of severance pay. App., *infra*, 3a-4a.

The post-petition severance plan was designed to encourage remaining employees to defer their job searches and to dedicate their time and efforts to the company. As a result, to be eligible for severance pay under the post-petition plan, an employee had to complete his last day of service as scheduled by the company. For those employees who did so, company executives received between six and 12 months of severance pay; full-time salaried and hourly employees who had been employed by the company for at least two years received one week of severance pay for every full year of service (up to a maximum of ten weeks for salaried employees and five weeks for hourly employees); and salaried and hourly employees with less than two years of service received one week of severance pay. All of these post-petition severance amounts were paid as a lump sum at the end of an employee's service. Under the post-petition plan, salaried employees received an average of 5.2 weeks of severance pay, while hourly employees received an average of 3.1 weeks of severance pay. App., *infra*, 4a.

b. For federal income-tax purposes, respondents reported the payments as wages on W-2 forms and withheld federal income tax. Respondents also treated the severance payments as taxable under FICA; they withheld and remitted to the Internal Revenue Service (IRS) both the FICA tax that they owed as employers and the FICA tax that their employees owed. In September 2002, however, respondents filed for a refund of approximately $1 million in FICA tax that they had paid as employers and that they had paid on behalf of roughly 1850 employees between late 1999 and mid-2002. Respondents subsequently filed the present adversary proceeding in the bankruptcy court seeking a refund of the $1 million in FICA tax. App., *infra*, 5a-6a.

3. a. The bankruptcy court granted summary judgment to respondents. App., *infra*, 55a-77a. The court's analysis focused not on the relevant FICA provisions, but on 26 U.S.C. 3402(*o*), which addresses the withholding of income tax. Based on the parties' stipulation of certain facts, the bankruptcy court found that the severance payments at issue here fall within Section 3402(*o*)(2)(A)'s definition of "supplemental unemployment compensation benefits." *Id.* at 63a-64a.[1] The court also accepted respondents' argument that "supplemental unemployment compensation benefits," as defined in Section 3402(*o*)(2)(A), "are not wages for income tax withholding purposes, but * * * are merely treated as if they were wages." *Id.* at 63a-64a (emphasis omitted). The bankruptcy court further concluded that Congress intended the definition of "wages" to be the same for purposes of income and FICA tax withholding, and it inferred that because "supplemental unemployment compensation benefits are not wages for purposes of income tax withholding, they are likewise not wages under FICA." *Id.* at 76a-77a (internal quotation marks omitted). The court found support for its conclusion in the decision of the Court of Federal Claims (CFC) in *CSX Corp.* v. *United States*, 52 Fed. Cl. 208 (2002).

b. After the bankruptcy court issued its decision in this case, the Federal Circuit reversed the CFC decision

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[1] The government stipulated that the severance payments at issue resulted from "an employee's involuntary separation from employment, resulting directly from a reduction in force or the discontinuance of a plant or operation." 05-80573-jdg, Doc. No. 21, at 4 (Bankr. W.D. Mich. Aug. 15, 2006). The parties further stipulated that the severance payments at issue were not tied to the receipt of state unemployment compensation and were not attributable to the rendering of any particular services by employees to respondents. See *id.* at 4-5.

on which the bankruptcy court had relied. See *CSX Corp.* v. *United States*, 518 F.3d 1328 (2008). The Federal Circuit held in *CSX Corp.* that the severance payments at issue in that case, which were made in connection with a company's reduction in force, were "wages" subject to FICA taxation. See *id.* at 1352. In light of the Federal Circuit's intervening decision in *CSX Corp.*, the government filed a motion for reconsideration in the present case. The bankruptcy court granted the government's motion but "ratified" its previous opinion and order without explanation. App., *infra*, 78a-80a.

4. The district court affirmed. App., *infra*, 33a-54a. The court recognized that FICA broadly defines the term "wages," and it agreed with the government that severance payments do not fall within any of the "statutory exceptions to [that] broad definition." *Id.* at 41a; see *id.* at 49a. The district court ruled in respondents' favor, however, on the same rationale as the bankruptcy court. The district court determined that the severance payments at issue here fall within Section 3402(*o*)(2)(A)'s definition of "supplemental unemployment compensation benefits"; that Section 3402(*o*) reflects Congress's view that any payments covered by that definition are not wages for purposes of income-tax withholding; and that such payments therefore should not be treated as wages for purposes of FICA tax withholding. See *id.* at 49a-50a. The district court acknowledged that its decision was in conflict with the Federal Circuit's decision in *CSX Corp.* See *id.* at 51a-52a.

5. The court of appeals affirmed. App., *infra*, 1a-30a. Like the bankruptcy and district courts, the court of appeals did not rest its decision on the text of the relevant FICA provisions. Rather, the court reasoned that, under this Court's decision in *Rowan Cos., Inc.* v. *United*

*States*, 452 U.S. 247 (1981), "the statutory term 'wages' should be interpreted consistently in the statutes governing FICA and the federal income tax." App., *infra*, 19a. The court further concluded that the severance payments at issue here fall within the definition of "supplemental unemployment compensation benefits" in Section 3402(*o*)(2)(A). *Id.* at 11a.

The court of appeals explained that, under Section 3402(*o*)(1), "any payment made to an employee that meets the statutory definition of a [supplemental unemployment compensation] payment 'shall be treated *as if it were a payment of wages* by an employer to an employee for a payroll period.'" App., *infra*, 11a (quoting 26 U.S.C. 3402(*o*)(1)) (emphasis added by court of appeals). The court found that "the necessary implication arising from [the italicized] phrase is that Congress did not consider [supplemental unemployment compensation] payments to be 'wages,' but allowed their treatment as wages to facilitate federal income tax withholding for taxpayers." *Id.* at 11a-12a. The court further reasoned that, if such payments "are not 'wages' but are only treated as if they were 'wages' for purposes of federal income tax withholding, then [such] payments also are not 'wages' under the nearly identical definition of that term found in the FICA statute." *Id.* at 13a-14a. Like the district court, the court of appeals recognized that its decision was in conflict with the Federal Circuit's decision in *CSX Corp.* See *id.* at 20a.

## REASONS FOR GRANTING THE PETITION

FICA broadly defines the term "wages" as all remuneration received for any service performed by an employee. See 26 U.S.C. 3121(a) and (b) (2006 & Supp. V 2011). The severance payments at issue in this case fit comfortably within that broad definition, which encom-

passes "the entire employer-employee relationship for which compensation is paid to the employee by the employer." *Social Sec. Bd.* v. *Nierotko*, 327 U.S. 358, 366 (1946). For several decades, moreover, the IRS has taken the position that payments like these are FICA wages, and Congress has taken no action to override that determination.

In holding that the severance payments here are not subject to FICA tax, the court of appeals did not suggest that those payments fall outside the applicable definition of "wages." Rather, the court relied on what it perceived to be the negative implication of 26 U.S.C. 3402(*o*), which mandates withholding of income tax from certain payments made to terminated employees. The court inferred that, because Section 3402(*o*)(2) states that any supplemental unemployment compensation benefit "shall be treated as if it were a payment of wages" for purposes of federal income-tax withholding, such payments should *not* be treated as wages for purposes of FICA taxation. As the Federal Circuit recognized in a factually analogous case, Section 3402(*o*) does not support that inference. See *CSX Corp.* v. *United States*, 518 F.3d 1328, 1340-1342 (2008). And, as the court below acknowledged (App., *infra*, 20a), the Sixth Circuit's decision in this case squarely conflicts with the Federal Circuit's decision in *CSX Corp.*

In addition to being in conflict with decisions of this Court and other courts of appeals, the question presented here is both recurring and important; the amount at issue for this and other claims exceeds $1 billion and is expected to grow. In light of the administrative importance of the issue, and the square circuit conflict, this Court's review is warranted.

**A. The Decision Below Is Incorrect**

1. a. FICA taxes finance Social Security and Medicare benefits. They are imposed on both employers and employees, and both elements of the tax are imposed on all "wages" paid by an employer or received by an employee "with respect to employment." 26 U.S.C. 3101(a) and (b), 3111(a) and (b). FICA defines "wages" in relevant part as "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash." 26 U.S.C. 3121(a) (2006 & Supp. V 2011). The Act defines "employment" in turn as "any service, of whatever nature, performed * * * by an employee for the person employing him." 26 U.S.C. 3121(b) (2006 & Supp. V 2011). FICA thus defines "wages" to include "all remuneration" paid for "any service" performed by an employee. On their face, those inclusive terms "import a breadth of coverage." *Mayo Found. for Med. Educ. & Research* v. *United States*, 131 S. Ct. 704, 715 (2011) (*Mayo Found.*) (quoting *Nierotko*, 327 U.S. at 365); *id.* at 709.

That broad definition of "wages" easily encompasses the severance payments at issue here. Those payments were undoubtedly a form of "remuneration." See, *e.g.*, *Black's Law Dictionary* 1409 (9th ed. 2009) (defining "remuneration" as "[p]ayment; compensation"); *Webster's Third New International Dictionary of the English Language* 1921 (1993) (defining "remunerate" as "to pay an equivalent to (a person) for a service, loss, or expense: recompense, compensate") (capitalization omitted); 8 *Oxford English Dictionary* 439 (1st ed. 1933) (defining "[r]emuneration" as "[r]eward, recompense, repayment; payment, pay"); see also *Nierotko*, 327 U.S. at 364 (concluding that "[s]urely" an award of back pay for an employee's wrongful discharge "is 'remuneration'").

Those payments were also made in return for "any service, of whatever nature, performed" by the employee. 26 U.S.C. 3121(b) (2006 & Supp. V 2011). The payments were calculated by reference to individual employees' positions, length of service, and former salaries.

This case involves payments made under two different severance plans, depending on whether employees were terminated before or after respondents entered into bankruptcy. Both plans made payments (either on a periodic basis or as a lump sum) once employees had been terminated, and both plans thus compensated those employees for their previous service. App., *infra*, 3a-4a. The post-petition plan served the further purpose of ensuring that, once respondents had entered bankruptcy, remaining employees would have an incentive to defer their job searches and dedicate their time and efforts to the company. *Id.* at 4a. Those employees who did so were then compensated for providing that additional service.

Both the pre-petition and post-petition severance plans at issue here provided compensation to employees for "service" that those employees had rendered to respondents. By defining "employment" expansively to include "any service, of whatever nature," FICA encompasses not only compensation for an employee's performance of specific functions but also compensation (like a bonus or severance payment) that accounts more generally for an employee's entire performance over some period of time. See, *e.g.*, *Rivera* v. *Baker West, Inc.*, 430 F.3d 1253, 1258 (9th Cir. 2005) (discussing "the broad, inclusive nature of 'employment'"); *Hemelt* v. *United States*, 122 F.3d 204, 209 (4th Cir. 1997) (same). FICA's inclusive definition of the terms "wages" and "employment" includes compensation based on and aris-

ing out of the employer-employee relationship, unless that type of compensation is excepted from the scope of the Act. The link between respondents' payments and the employees' prior service is particularly clear in this case because the amounts of the various employees' payments were calculated by reference to the positions those individuals had held within respondents' work force, the length of time the employees had worked for respondents, and the salaries they had earned during their periods of service.

b. FICA contains specific exceptions to both "wages" and "employment"—*i.e.*, types of remuneration that do not constitute wages, see 26 U.S.C. 3121(a)(1)-(23) (2006 & Supp. V 2011), and types of services that do not constitute employment, see 26 U.S.C. 3121(b)(1)-(21) (2006 & Supp. V 2011). This Court has observed that the specificity of the exceptions is an additional reason why the terms "wages" and "employment" should be construed broadly. See *United States* v. *Silk*, 331 U.S. 704, 711-712 (1947) ("The very specificity of the exemptions * * * and the generality of the employment definitions indicates that the terms 'employment' and 'employee,' are to be construed to accomplish the purposes of the legislation.") (footnote omitted); cf. *Mayo Found.*, 131 S. Ct. at 715 ("[W]e have instructed that 'exemptions from taxation are to be construed narrowly.'") (quoting *Bingler* v. *Johnson*, 394 U.S. 741, 752 (1969)). Respondents do not contend, and the court of appeals did not hold, that the severance payments at issue here fall within any of the statutory exceptions to "wages."

c. Between 1956 and 1990, the IRS issued numerous Revenue Rulings addressing whether particular payments to terminated employees should be treated as "wages" for purposes of income-tax or FICA withhold-

ing. See generally *CSX Corp.*, 518 F.3d at 1335-1340. Under the framework the IRS developed during that period, the severance payments at issue in this case are clearly FICA "wages."

i. In the mid-1950s, several large industrial employers adopted plans pursuant to collective bargaining in which the employers agreed to fund trusts that would supplement state unemployment compensation benefits for workers who were terminated. See *CSX Corp.*, 518 F.3d at 1334. Those supplemental benefits depended for their effectiveness on their not being treated as "wages," because employees in many States were ineligible for unemployment benefits if they were receiving wages from employers. As a result, if the supplemental benefits paid by employers were treated as wages, many employees would lose the state unemployment benefits that their employers' payments were intended to supplement. See *id.* at 1335.

In 1956, the IRS issued a Revenue Ruling addressing the status, for income-tax and FICA purposes, of payments made by one such trust. See Rev. Rul. 56-249, 1956-1 C.B. 488. The IRS identified eight different factors as supporting the conclusion that those payments were not "wages." The IRS explained, *inter alia*, that "the amount of [such] benefit[s] * * * is based upon * * * the appropriate State unemployment compensation laws." *Id.* at 492.

The plan at issue in the 1956 Revenue Ruling was the result of collective bargaining, and it created a trust to make periodic payments to terminated employees. Over the next four years, the IRS issued a series of Revenue Rulings explaining that the principles of the 1956 Revenue Ruling would apply with equal force to plans that were unilaterally instituted by an employer, Rev. Rul.

58-128, 1958-1 C.B. 89; that made lump sum rather than periodic payments to employees, see Rev. Rul. 59-227, 1959-2 C.B. 13; and that made payments directly to employees rather than through a trust, see Rev. Rul. 60-330, 1960-2 C.B. 46. The IRS specified, however, that in order not to result in the payment of "wages," plans had to be "similar in all material details" to the plan at issue in the 1956 Revenue Ruling. Rev. Rul. 58-128, 1958-1 C.B. at 90; see Rev. Rul. 60-330, 1960-2 C.B. at 48.

ii. Until 1950, the FICA definition of "wages" excluded "[d]ismissal payments which the employer is not legally required to make." 26 U.S.C. 1426(a)(4) (1946). In 1950, however, Congress amended FICA to eliminate that exception. See Social Security Act Amendments of 1950, ch. 809, 64 Stat. 477. Both before and after the passage of Section 3402(*o*), the IRS issued Revenue Rulings concluding that various types of dismissal payments were "wages." In 1965, the IRS ruled that "[l]ump sum separation and severance allowances paid to laid-off employees in the railroad industry" constituted "wages" subject to income-tax withholding and "compensation" subject to taxation under the Railroad Retirement Tax Act (which is the equivalent of FICA in the railroad industry). Rev. Rul. 65-251, 1965-2 C.B. 395. In 1971, the IRS ruled that "[d]ismissal payments made to former employees" were "wages" subject to both FICA tax and income-tax withholding. Rev. Rul. 71-408, 1971-2 C.B. 340. In that case, a company went out of business and made payments to terminated employees with five years or more service with the company. *Id.* at 341. As in this case, "[t]he computation of the amount of each employee's award took into account the employee's rate of pay and years of service." *Ibid.* The IRS concluded that

"the amounts of dismissal payments [were] 'wages' for purposes of [FICA]." *Ibid.*

iii. In 1990, the IRS set forth in detail its position on the relationship between the two categories of payments described above and the criteria that govern the determination whether particular payments to terminated employees are FICA "wages." The IRS explained that, to be exempt from FICA's definition of "wages," payments made to terminated employees must be "linked to state unemployment compensation" and "designed to supplement the receipt of state unemployment compensation." Rev. Rul. 90-72, 1990-2 C.B. 211, 212. Under that approach, the severance payments at issue here clearly are not exempt from FICA taxation because they are wholly unconnected to state unemployment compensation. Rather, like the dismissal payments found to be FICA "wages" in the 1971 Revenue Ruling, the payments are calculated by reference to individual employees' positions, length of service, and former salaries.

2. The court of appeals did not rest its analysis on the FICA provisions that define the terms "wages" and "employment," 26 U.S.C. 3121(a) and (b) (2006 & Supp. V 2011). Rather, the court relied on 26 U.S.C. 3402(*o*), which governs the withholding of federal income tax. App., *infra*, 10a-14a. Section 3402(*o*) is entitled "[e]xtension of withholding to certain payments other than wages" and states that "any supplemental unemployment compensation benefit paid to an individual * * * shall be treated *as if it were a payment of wages* by an employer to an employee for a payroll period." 26 U.S.C. 3402(*o*)(1)(A) (emphasis added).

The court of appeals held that the severance payments at issue in this case fall within the definition of "supplemental unemployment compensation benefit"

contained in Section 3402(*o*)(2)(A). See App., *infra*, 11a. Based on Congress's directive that any such payment "shall be treated as if it were a payment of wages" for purposes of income-tax withholding, the court inferred that payments covered by that definition are not *in fact* wages for income-tax purposes. See *id.* at 11a-12a. The court further determined that, under this Court's decision in *Rowan Cos., Inc.* v. *United States*, 452 U.S. 247 (1981), "the statutory term 'wages' should be interpreted consistently in the statutes governing FICA and the federal income tax." App., *infra*, 19a. The court concluded that, because (in its view) respondents' severance payments "are not 'wages' but are only treated as if they were 'wages' for purposes of federal income tax withholding, then [such] payments also are not 'wages' under the nearly identical definition of that term found in the FICA statute." *Id.* at 13a-14a. The court of appeals' chain of reasoning reflects significant misunderstandings of Section 3402(*o*)'s text, history, and purpose.

a. The court of appeals gave insufficient weight to the prefatory language of Section 3402(*o*)(1), which states that the rules therein—including the rule that supplemental unemployment compensation payments shall be treated as wages for purposes of income tax withholding—apply "[f]or purposes of this chapter (and so much of subtitle F as relates to this chapter)." The applicability of Section 3402(*o*)(1) is thus expressly limited to Chapter 24 (income tax withholding) and those portions of Subtitle F (matters of procedure and administration) that relate to Chapter 24. By contrast, FICA is codified at Chapter 21 of the Internal Revenue Code. As the Federal Circuit has explained, "Congress's decision to restrict the scope of the rule set forth in [S]ection 3402(*o*) to chapter 24 suggests that Congress

did not intend that rule, or any implication that might be drawn from that rule, to be applied outside the context of income tax withholding." *CSX Corp.*, 518 F.3d at 1341. The court of appeals therefore should have construed FICA's definition of "wages" with reference to its own terms, not by drawing inferences from Section 3402(*o*).

b. The history of Section 3402(*o*) belies any suggestion that the provision was intended to exempt from FICA taxation payments that would otherwise be treated as FICA "wages." Rather, Section 3402(*o*) was Congress's response to a different problem dealing with a particular category of unemployment compensation benefits. As explained above, the IRS determined in 1956, and confirmed in later Revenue Rulings, that certain payments linked to state unemployment compensation schemes should not be viewed as "wages." The IRS's 1956 Revenue Ruling noted, however, that such payments were nevertheless "includible in the gross incomes" of recipients. Rev. Rul. 56-249, 1956-1 C.B. at 488; see *CSX Corp.*, 518 F.3d at 1336.

Because those supplemental payments were taxable as income to recipients, but were not subject to income-tax withholding as "wages," recipients found themselves subject to substantial tax obligations when they filed their returns. See *CSX Corp.*, 518 F.3d at 1336. In 1969, at the Treasury Department's suggestion, Congress enacted Section 3402(*o*) to address that particular problem. Section 3402(*o*) provides that "any supplemental unemployment compensation benefit paid to an individual * * * shall be treated as if it were a payment of wages by an employer to an employee for a payroll period." 26 U.S.C. 3402(*o*)(1)(A). Section 3402(*o*) thus ensures that supplemental unemployment compen-

sation benefits, even if not deemed wages, are subject to income-tax withholding by employers. Section 3402(*o*) also defines the term "supplemental unemployment compensation benefits" broadly to encompass the different types of plans that employers had developed prior to its enactment. See 26 U.S.C. 3402(*o*)(2)(A); see also *CSX Corp.*, 518 F.3d at 1336-1337.

As explained above, the IRS has long distinguished, for both FICA and income-tax purposes, between different types of payments made by employers to terminated employees. In enacting Section 3402(*o*), Congress did not seek either to redraw the line that the IRS had drawn, or to restrict the IRS's authority (within the limits established by other provisions of law) to determine which such payments should be treated as "wages." See Rev. Rul. 90-72, 1990-2 C.B. at 211 (explaining that "[t]he definition of [supplemental unemployment compensation benefit] pay under [S]ection 3402(o) is not applicable for FICA * * * purposes"). Congress simply addressed a practical difficulty that had arisen by reason of the fact that certain non-wage payments were still part of the recipient's gross income and therefore were ultimately subject to federal income tax even in the absence of withholding.

c. On its face, Section 3402(*o*)(2)(A)'s broad definition of "[s]upplemental unemployment compensation benefits" encompasses *both* the payments linked to state unemployment compensation that the IRS had historically treated as non-wage income, and the dismissal payments that the IRS had viewed as "wages." So long as Section 3402(*o*) is given only the effect that its language literally dictates (*i.e.*, that "supplemental unemployment compensation benefits" as defined in the statute be subject to income-tax withholding), the breadth of the statutory

definition is of no practical concern. "For purposes of chapter 24 (income tax withholding), it was not important for Congress to define [supplemental unemployment compensation benefit] payments narrowly or to distinguish between [supplemental unemployment compensation benefit] payments and 'dismissal' payments, since both were treated similarly for withholding purposes." *CSX Corp.*, 518 F.3d at 1340. If, in some of its applications, Section 3402(*o*) mandates withholding of income tax from payments that would *already* be subject to income-tax withholding, no practical harm is done.

The breadth of the statutory definition creates anomalous results, however, if payments within that definition are viewed for all purposes as non-wage income. As the Federal Circuit explained in *CSX Corp.*, "if [S]ection 3402(*o*) is deemed to render all [supplemental unemployment compensation benefit] payments (as defined therein) non-wages, and if the non-wage character of [supplemental unemployment compensation benefit] payments (as so defined) is deemed to apply to FICA, [Section 3402(*o*)] creates a square conflict with the treatment of dismissal payments as wages under FICA since 1950." 518 F.3d at 1341. Neither the text nor the history of Section 3402(*o*) provides any sound basis for construing it to override IRS practice in that manner. Section 3402(*o*) applies by its terms only for purposes of specified income-tax-related provisions, see pp. 15-16, *supra*, and it was designed to *increase* the incidence of income-tax withholding. If Congress had sought to *eliminate* FICA withholding from the sorts of dismissal payments that the IRS had historically treated as FICA wages, the language it used in Section 3402(*o*) would

have been a remarkably oblique way of accomplishing that result.

To be sure, Section 3402(*o*) reflects Congress's understanding that *some* of the payments encompassed by the statutory definition of "supplemental unemployment compensation benefits" would not otherwise be viewed as "wages." The provision would have served no useful purpose if *all* such payments were already subject to income-tax withholding. But "[t]o say that all payments falling within a particular category shall be treated as if they were a payment of wages does not dictate, as a matter of language or logic, that *none* of the payments within that category would otherwise be wages. For example, to say that for some purposes all men shall be treated as if they were six feet tall does not imply that no men are six feet tall." *CSX Corp.*, 518 F.3d at 1342 (emphasis added).[2]

Thus, Section 3402(*o*) simply directs that payments encompassed by the statutory definition will be subject to income-tax withholding *whether or not* they would

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[2] The court of appeals also relied in part on the title of Section 3402(*o*), "Extension of withholding to certain payments other than wages." The court stated that "[t]he phrase 'other than wages' supports our conclusion that Congress knew that it was extending federal income tax withholding to payments 'other than wages' when it enacted [Section] 3402(*o*)." App., *infra*, 12a-13a. Under the government's reading, however, the purpose and effect of Section 3402(*o*) was to extend income-tax withholding to "payments other than wages," namely the payments related to state unemployment compensation that the IRS had treated, in the 1956 Revenue Ruling and subsequently, as non-wage income. The fact that the statutory definition of "supplemental unemployment compensation benefits" also encompasses some wage payments neither vitiates that intent nor renders the government's reading inconsistent with the title of Section 3402(*o*).

otherwise be "wages." The provision does not explicitly address, and has no logical bearing on, the determination whether particular payments to terminated employees are subject to FICA taxation. Rather, that determination is governed by other provisions of law. And, once Section 3402(*o*) is understood to be irrelevant to questions of FICA taxation, the severance payments at issue here clearly constitute FICA "wages." See pp. 8-14, *supra*.

**B. The Decision Below Conflicts With Decisions Of This Court And Other Courts Of Appeals**

1. The court of appeals' decision is inconsistent with this Court's decision in *Nierotko*, *supra*. In that case, an employee had been wrongfully discharged and was ordered to be reinstated by his employer with back pay. See 327 U.S. at 359-360. The question in *Nierotko* was whether the back pay award constituted "wages" under the Social Security Act, which defined that term in the same way as FICA. See *id.* at 362-363.

In applying that statutory definition, the Court in *Nierotko* first held that "the back pay is remuneration." 327 U.S. at 364 (internal quotation marks omitted). It then held that the back pay was awarded for the employee's "service," even though he had not worked during the period of his wrongful discharge. The Court explained that "[t]he very words 'any service . . . performed . . . for his employer,' with the purpose of the Social Security Act in mind, import breadth of coverage. They admonish us against holding that 'service' can be only productive activity." *Id.* at 365. The Court concluded that "'service' as used by Congress in this definitive phrase means not only work actually done but the entire employer-employee relationship for which com-

pensation is paid to the employee by the employer." *Id.* at 365-366.

The Court's reasoning in *Nierotko* indicates that the severance payments at issue here constitute wages for FICA purposes. Respondents' severance payments were compensation for "service, of whatever nature, performed" by their employees, 26 U.S.C. 3121(b) (2006 & Supp V. 2011), because those payments were based on, and made on account of, "the entire employer-employee relationship," *Nierotko*, 327 U.S. at 366. The amount of employees' severance payments depended on their level of seniority, length of service with the company, and regular rate of pay. See pp. 3-4, *supra*. All of those factors depend on "the entire employer-employee relationship," and all of them are usual factors associated with determining the level of an employee's compensation. Just as this Court in *Nierotko* rejected the notion that "[a] back pay award differs from other pay," 327 U.S. at 368 (internal quotation marks omitted), the court of appeals should have rejected respondents' argument that a severance payment differs in kind from other types of pay received by employees in return for services rendered to their employers.

2. Nor does it matter that, unlike in *Nierotko*, the severance payments at issue here were made at the conclusion of employees' work for respondents. In *Otte* v. *United States*, 419 U.S. 43 (1974), former employees of a corporation that had declared bankruptcy filed claims with the trustee for unpaid wages. See *id.* at 45. The trustee proposed to pay the claims without withholding federal income and FICA taxes. See *id.* at 46. This Court held that such withholding was necessary. See *id.* at 49-51. The Court observed that the relevant income-tax provisions defined "wages" as remuneration for ser-

vices that an employee "performs or performed." *Id.* at 49. The Court thus reasoned that the statutory language "speaks in the past tense as well as the present and thereby plainly reveals that a continuing employment relationship is not a prerequisite for a payment's qualification as 'wages.'" *Id.* at 49-50. "The situation is the same with respect to FICA withholding," the Court explained, because "the payments clearly are 'wages' under that statute, even though again, at the time of payment, the employment relationship between the bankrupt and the claimant no longer exists." *Id.* at 51; see 26 U.S.C. 3121(b) (2006 & Supp. V 2011) (referring to "service, of whatever nature, *performed*" by an employee) (emphasis added).[3]

3. Since *Nierotko* and *Otte*, the Third and Federal Circuits have held that various types of severance payments made at the conclusion of a worker's employment relationship are "wages" for FICA purposes. See, *e.g.*, *University of Pittsburgh* v. *United States*, 507 F.3d 165, 171-172 (3d Cir. 2007) (early retirement payments to

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[3] The court of appeals' reliance (App., *infra*, 9a) on *Coffy* v. *Republic Steel Corp.*, 447 U.S. 191 (1980), is misplaced. Although *Coffy* involved payments made to laid-off employees, see *id.* at 198-199, the Court did not address whether those payments were "wages" for either FICA or income-tax purposes. Rather, the disputed issue was whether those payments were "perquisites of seniority" to which a returning veteran was entitled under the Vietnam Era Veterans' Readjustment Assistance Act of 1974. See *id.* at 193. In holding that the payments were covered by that statute, the Court emphasized that the payments were "in the nature of a reward for length of service, and do not represent deferred short-term compensation for services actually rendered." *Id.* at 205. *Nierotko* makes clear, however, that payments from an employer to an employee may be FICA "wages" even if they do not compensate the employee "for services actually rendered."

faculty members were "wages" taxable under FICA); *Abrahamsen* v. *United States*, 228 F.3d 1360, 1365 (Fed. Cir. 2000) (same; buyout payments to employees who agreed to resign or retire and release the employer from liability), cert. denied, 532 U.S. 957 (2001). Indeed, the Sixth Circuit itself reached the same conclusion in a similar case. See *Appoloni* v. *United States*, 450 F.3d 185, 191-192 (2006) (severance payments to public school teachers who agreed to resign statutory tenure rights and their teaching positions were "wages" taxable under FICA), cert. denied, 549 U.S. 1165 (2007). The Eighth Circuit has held that early retirement payments to high-level administrators, but not those made to tenured faculty members, were "wages" taxable under FICA, on the theory that the payments to tenured professors were made in exchange for relinquishment of contractual and constitutionally-protected rights, rather than as compensation for services rendered. See *North Dakota State Univ.* v. *United States*, 255 F.3d 599, 600 (2001). None of those courts treated 26 U.S.C. 3402(*o*) as in any way relevant to the determination whether particular payments were FICA "wages."

The Third and Federal Circuits have also recognized that when, as here, the amount of a payment to a departing employee is based on factors like the employee's salary and years of service to the company, those factors indicate that the payment is compensation for past services rendered by the employee. The payment therefore arises from the employer-employee relationship and constitutes "wages" for FICA purposes. See, *e.g.*, *University of Pittsburgh*, 507 F.3d at 172 ("[E]ligibility for the Plans * * * was based on the employee's age and years of service. These requirements link the Plan payments to past services for the employer * * * and

weigh heavily in favor of treating the payments as wages."); *Abrahamsen*, 228 F.3d at 1365 ("[T]he agreements set the amount of the lump-sum cash payments using a formula based on the departing employee's salary and years of service * * * . This formula further associates the payments with the employer-employee relationship."). Again, the Sixth Circuit recognized the same thing in its earlier decision in *Appoloni*. See 450 F.3d at 191 ("[T]he eligibility requirements for qualifying for a payment—that a teacher served a minimum number of years—indicate the payments were for services performed."). Applying that reasoning here would have resulted in a different outcome.

4. Most recently, the Federal Circuit held in *CSX Corp.* that severance payments made in connection with a company's reduction in force are "wages" for purposes of FICA taxation. See 518 F.3d at 1352. In *CSX Corp.*, a group of railroad companies responded to financial difficulties by paying a number of their employees to leave their jobs or reduce their hours. See *id.* at 1330. The Federal Circuit followed the majority of courts of appeals in determining that a severance payment "designed to induce the employee to leave or to cushion the effect of a separation * * * constitute[s] taxable wages and compensation." *Id.* at 1348; see *id.* at 1347-1349. In so concluding, the Federal Circuit rejected the very argument that the Sixth Circuit adopted here: namely, that all severance payments encompassed by Section 3402(*o*)(2)(A)'s definition of "supplemental unemployment compensation benefits" should be considered non-wage payments for FICA purposes. See *id.* at 1341-1345. The decision below thus squarely conflicts with the Federal Circuit's decision in *CSX Corp.*, as the

courts below recognized. See App., *infra*, 20a, 51a-52a. This Court's review is warranted to resolve the conflict.

### C. The Question Presented Is Recurring And Exceptionally Important

The proper tax treatment of severance pay under FICA is an issue of exceptional importance. According to the IRS, that question is currently pending in eleven cases and more than 2400 administrative refund claims, with a total amount at stake of more than $1 billion. That figure is expected to grow. In addition, the decision below has significant potential implications outside the tax context with respect to the administration of Social Security and Railroad Retirement Act benefits. A payment's designation as "wages" affects whether employees earn wage credits, which in turn affects the amount of benefits that employees accrue. See 42 U.S.C. 401 *et seq.*; see also 20 C.F.R. 404.1001. In light of the substantial effect that the decision below will have both on the public fisc and on employers and employees in the Sixth Circuit, this Court's review is warranted.

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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MAY 2013

## APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

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No. 10-1563

IN RE QUALITY STORES, INC., ET AL., DEBTORS
UNITED STATES OF AMERICA, APPELLANT

*v.*

QUALITY STORES, INC., ET AL., APPELLEES

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Argued: Oct. 6, 2011
Decided and Filed: Sept. 7, 2012

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## OPINION

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Before: BOGGS and STRANCH, Circuit Judges; and CARR, District Judge.*

JANE B. STRANCH, Circuit Judge.

This appeal arises from an adversary action filed in the bankruptcy court for the Western District of Michigan by Quality Stores, Inc., its affiliated companies, and certain employees (collectively Quality Stores) against the United

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* The Honorable James G. Carr, Senior United States District Judge for the Northern District of Ohio, sitting by designation.

States seeking a refund of $1,000,125 in taxes paid under the Federal Insurance Contributions Act (FICA).[1] On stipulated facts and cross-motions for summary judgment, the bankruptcy court ordered a full refund, holding that payments Quality Stores made to its employees upon terminating their employment involuntarily due to business cessation constituted supplemental unemployment compensation benefits (SUB payments) that are not taxable as wages under FICA. *Quality Stores, Inc. v. United States (In re Quality Stores, Inc.)*, 383 B.R. 67 (Bankr. W.D. Mich. 2008). On appeal, the district court affirmed, *United States v. Quality Stores, Inc. (In re Quality Stores, Inc.)*, 424 B.R. 237 (W.D. Mich. 2010), and we now AFFIRM.

## I. FACTS

Quality Stores was the largest agricultural-specialty retailer in the country serving farmers, hobby gardeners, skilled trade persons, and do-it-yourself customers. In October 2001, an involuntary Chapter 11 bankruptcy petition was filed against Quality Stores, Inc. Within two weeks, Quality Stores answered the petition and consented to the entry of an order for relief. Thereafter, Quality Stores's affiliated companies commenced voluntary Chapter 11 bankruptcy cases.[2] In May 2002, the

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[1] Quality Stores is supported in this appeal by *amici curiae*, American Payroll Association and ERISA Industry Committee.

[2] The debtors are: QSI Holdings, Inc. (f/k/a CT Holdings, Inc.), Quality Stores, Inc. (f/k/a Central Tractor Farm & Country, Inc.), Country General, Inc., F and C Holding, Inc., FarmandCountry .com, LLC, QSI Newco, Inc., QSI Transportation, Inc., Quality

bankruptcy court confirmed the First Amended Joint Plan of Reorganization.

Prior to November 1, 2001, Quality Stores closed sixty-three stores and nine distribution centers and terminated the employment of approximately seventy-five employees in the corporate office. After November 1, 2001, Quality Stores closed its remaining 311 stores and three distribution centers and terminated the employment of all remaining employees.

Quality Stores made severance payments to those employees whose employment was involuntarily terminated. The parties stipulated that the severance payments resulted directly from a reduction in force or the discontinuance of a plant or operation. Quality Stores made the severance payments pursuant to two separate plans.

Under the terms of the Pre-Petition Severance Plan, severance pay was based on job grade and management level in the organization. The President and CEO received eighteen months of severance pay. Senior management executives received twelve months of severance pay, while all other managers and employees received one week of severance pay for each full year of service. These severance payments were not tied to the receipt of state unemployment compensation, and they were not attributable to the provision of any particular services by the employees. Quality Stores made the severance pay-

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Farm & Fleet, Inc., Quality Investments, Inc., Quality Stores Services, Inc., and Vision Transportation, Inc.

ments on the normal payroll schedule. Salaried employees received an average of 11.4 weeks of severance pay, while hourly employees received an average of 4.2 weeks of severance pay.

The Post-Petition Severance Plan was designed to encourage employees to defer their job searches and dedicate their efforts and attention to the company by assuring them that they would receive severance pay if their jobs were eliminated. To be eligible for severance pay, an employee was required to complete the last day of service as scheduled. Company officers received between six and twelve months of severance pay, while full-time salaried and hourly employees who had been employed for at least two years received one week of severance pay for every full year of service, up to a maximum of ten weeks for salaried employees and five weeks for hourly employees. Those workers with less than two years of service received one week of severance pay.

Severance payments made under the Post-Petition Severance Plan were not tied to the receipt of state unemployment compensation, nor were they attributable to the provision of any particular services. The post-petition severance amounts were paid in a lump sum, however, because the companies were liquidating and it was not practical administratively to pay the amounts over time. Under the Post-Petition Severance Plan, on average, salaried employees received 5.2 weeks of severance pay, while hourly employees received 3.1 weeks of severance pay. About 900 employees did not receive any severance pay because they were hired immediately by successor companies.

Quality Stores did not require employees to prove that they were unemployed in order to receive severance pay under either plan. Because the severance payments constituted gross income to the employees for federal income tax purposes, Quality Stores reported the payments as wages on W-2 forms and withheld federal income tax. Quality Stores also paid the employer's share of FICA tax and withheld each employee's share of FICA tax. For the taxable quarters ending December 31, 1999, through June 30, 2002, Quality Stores filed timely Forms 941 reporting wages paid to employees and remitted the applicable FICA taxes.

Of the total $1,000,125 in FICA tax at issue, $382,362 is attributed to severance payments made under the Pre-Petition Severance Plan, consisting of $214,000 for the employer share and $168,362 for the employee share. Further, of the total amount of FICA tax at issue, $617,763 is attributed to severance payments made under the Post-Petition Severance Plan, consisting of $357,127 for the employer share and $260,636 for the employee share.

Although Quality Stores collected and paid the FICA tax, it did not agree with the Internal Revenue Service (IRS) that the severance payments constituted wages for FICA purposes. Quality Stores took the position that the payments made to its employees pursuant to the plans were not wages but instead constituted SUB payments that were not taxable under FICA.

Quality Stores asked 3,100 former employees to allow the company to file FICA tax refund claims on their behalf. *See* Treas. Reg. § 31.6402(a)-2. Of those con-

tacted, 1,850 former employees allowed Quality Stores to pursue FICA tax refunds for them.

In September 2002, Quality Stores timely filed with the IRS fifteen Forms 843 seeking the refund of $1,000,125 in FICA tax.[3] This figure consisted of $571,127 for the employer share and $428,998 for the employee share attributed to those employees who granted Quality Stores consent to pursue their claims. When the IRS did not allow or deny the refund claims, Quality Stores filed an adversary action in the bankruptcy court in June 2005.

## II. STANDARD OF REVIEW

When we consider an appeal from a district court judgment in a case that originated in bankruptcy court, we review the bankruptcy court's decision directly, without giving any deference to the district court's decision. *Stevenson v. J.C. Bradford & Co. (In re Cannon)*, 277 F.3d 838, 849 (6th Cir. 2002). Because the bankruptcy court decided the case on stipulated facts and cross-motions for summary judgment, our review is *de novo*. *See id.*

## III. ANALYSIS

The concept of SUB payments first appeared in the 1950s and "evolved from the demand by organized labor for a guaranteed annual wage." *Coffy v. Republic Steel Corp.*, 447 U.S. 191, 200, 100 S. Ct. 2100, 65 L. Ed. 2d 53 (1980). Because the unions' real concern was the signif-

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[3] The Forms 843 were filed by Central Tractor Farm & Country, Inc., Country General, Inc., Quality Farm & Fleet, Inc., and Quality Stores Services, Inc.

icant difference between average weekly earnings received when employed and the amount of unemployment benefits received when unemployed, the unions sought corporate supplementation of existing state unemployment compensation programs. *See id.* Several industries adopted SUB plans, the purpose of which was to assure workers of employment security regardless of the number of hours actually worked, rather than to provide employees with additional compensation for work performed. *Id.* SUB payments "cannot be compensation for work performed, . . . for they are contingent on the employee's being thrown out of work; unless the employee is laid off he will never receive SUB payments. In this sense, SUB's are analogous to severance payments: they are 'compensation for loss of jobs.'" *Id.* (quoting *Accardi v. Pa. R.R. Co.*, 383 U.S. 225, 230, 86 S. Ct. 768, 15 L. Ed. 2d 717 (1966) ("[T]he cost to an employee of losing his job is not measured by how much work he did in the past . . . but by the rights and benefits he forfeits by giving up his job.")) SUB payments are "in the nature of a reward for length of service, and do not represent deferred short-term compensation for services actually rendered." *Id.* at 205, 100 S. Ct. 2100.

Consistent with these principles, Quality Stores developed two written plans to administer severance payments to the managers and hourly employees who permanently lost their jobs due to the cessation of business caused by bankruptcy. The related questions we must resolve are whether those payments constitute SUB pay-

ments under federal law and, if so, whether the payments are taxable under FICA.

**A. Background**

Congress imposed the FICA tax on employee wages to fund the Social Security and Medicare programs. *Appoloni v. United States*, 450 F.3d 185, 189 (6th Cir. 2006). Both the employer and the employee pay part of the tax. The employer collects the employee's share by deducting the tax from wages as they are paid. I.R.C. §§ 3101(a), 3102(a). The employer also pays a matching tax on the wages paid to the employee. I.R.C. § 3111(a).

Congress defined "wages" for FICA purposes (with certain exceptions) as "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash. . . . " I.R.C. § 3121(a). "Employment," as used in the statute, means "any service, of whatever nature, performed . . . by an employee for the person employing him. . . . " I.R.C. § 3121(b). The Supreme Court has explained that the words

> "any service . . . performed . . . for his employer," with the purpose of the Social Security Act in mind[,] import breadth of coverage. They admonish us against holding that "service" can be only productive activity. We think that "service" as used by Congress in this definitive phrase means not only work actually done but the entire employer-employee relationship for which compensation is paid to the employee by the employer.

*Soc. Sec. Bd. v. Nierotko*, 327 U.S. 358, 365-66, 66 S. Ct. 637, 90 L. Ed. 718 (1946). Thus, the Supreme Court held that back pay granted to an employee pursuant to an order of the National Labor Relations Board constituted "wages" taxable under FICA. *Id.* at 369-70, 66 S. Ct. 637. Likewise, we have construed FICA definitions broadly and inclusively, *Appoloni*, 450 F.3d at 190, and we generally favor "that interpretation of statutory provisions which calls for coverage rather than exclusion," *St. Luke's Hosp. Ass'n v. United States*, 333 F.2d 157, 164 (6th Cir. 1964); *United States v. Detroit Med. Ctr.*, 557 F.3d 412, 414 (6th Cir. 2009). But in this case we must begin with the Supreme Court's particular instruction that SUB pay falls outside the broad statutory meaning of service performed by an employee for an employer because, by definition, an employee is not eligible for SUB pay until service to the employer has ended and such benefits provide compensation for the lost job. *Coffy*, 447 U.S. at 200, 100 S. Ct. 2100.

**B. FICA, Federal Income Tax Withholding, and "Wages"**

Whether SUB payments are "wages" under FICA is a complex question because the FICA statute does not expressly include or exclude SUB payments, nor do the Treasury regulations promulgated under FICA address the subject. Mindful of the Supreme Court's admonition that SUB payments cannot, by their nature, be compensation for work performed, *id.*, we first ask whether Congress has provided any direction or insight into the proper treatment of SUB payments for tax purposes.

We observe that, for purposes of federal income tax withholding, I.R.C. § 3402, Congress adopted a definition of "wages" that is nearly identical to the definition of "wages" included in FICA. In the income tax context, "wages" means "all remuneration . . . for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash. . . . " I.R.C. § 3401(a). In addition to this definition of "wages," Congress expressly defined SUB payments for purposes of federal income tax withholding in a subsection of the statute entitled, **"Extension of withholding to certain payments *other than wages*."** I.R.C. § 3402(*o*) (emphasis added). In that subsection of the statute, Congress defined SUB payments as:

> amounts which are paid to an employee, pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment (whether or not such separation is temporary), resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, but only to the extent such benefits are includible in the employee's gross income.

I.R.C. § 3402(*o*)(2)(A). This statutory definition of SUB payments is repeated in the corresponding Treasury Regulation, § 31.3401(a)-1(b)(14)(ii).

Parsing this definition into its five separate elements, Congress has provided that a SUB payment is: (1) an amount paid to an employee; (2) pursuant to an employer's plan; (3) because of an employee's involuntary separation from employment, whether temporary or perma-

nent; (4) resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions; and (5) included in the employee's gross income.

All payments Quality Stores made to its former employees, whether under the Pre- or Post-Petition Plan, satisfy this five-part statutory test to qualify as SUB payments. The parties stipulated below that: (1) Quality Stores made the payments to employees; (2) pursuant to company plans; (3) because of the employees' permanent separation from employment; and (4) resulting directly from a reduction in force or the discontinuance of a plant or operation. Although the parties' stipulation did not contain any reference to gross income as contemplated by the fifth element of the statutory test, as a matter of law the SUB payments were included in the employees' gross incomes. *See* I.R.C. § 61 (generally "gross income means all income from whatever source derived" with certain inapplicable exceptions). The statutory definition does not require that SUB payments be tied to an employee's receipt of state unemployment compensation benefits, nor does the statute make any distinction between periodic payments or one-time payments made in a lump sum.

Congress expressly provided that any payment made to an employee that meets the statutory definition of a SUB payment "shall be treated *as if it were a payment of wages* by an employer to an employee for a payroll period." I.R.C. § 3402(*o*)(1) (emphasis added). In our view, the necessary implication arising from this phrase is that Congress did not consider SUB payments to be "wages,"

but allowed their treatment as wages to facilitate federal income tax withholding for taxpayers. To the extent other plausible inferences might be drawn, the statute may be ambiguous.

Our objective when interpreting statutes is to give effect to the intent of Congress, and if that intent is clear, then both the courts and the government agency charged with implementing the statute, here the IRS, must give effect to that clear congressional intent. *See Nat'l Ass'n of Home Builders v. Defenders of Wildlife*, 551 U.S. 644, 665, 127 S. Ct. 2518, 168 L. Ed. 2d 467 (2007). If a statute is silent or ambiguous, the question we ask is whether the agency's approach to interpretation is based on a permissible construction of the statute. *Id.*

Where ambiguity exists, we may use aids to statutory construction to help us resolve the ambiguity. We may consider the title of the statute and the legislative history leading to its enactment, although the title and history cannot limit the plain meaning of the statutory text. *See Maguire v. Comm'r of Internal Revenue*, 313 U.S. 1, 9, 61 S. Ct. 789, 85 L.Ed. 1149 (1941); *Fairport, P. & E.R. Co. v. Meredith*, 292 U.S. 589, 594, 54 S. Ct. 826, 78 L. Ed. 1446 (1934). Thus, we turn to the title and legislative history of § 3402(*o*) to assist us in determining whether the inference we read into the statute is consistent with congressional intent.

The title of § 3402(*o*) is: **"Extension of withholding to certain payments other than wages."** The phrase "other than wages" supports our conclusion that Congress knew

that it was extending federal income tax withholding to payments "other than wages" when it enacted § 3402(o).

Moreover, the legislative history of the statute confirms our interpretation. When § 3402(o) was enacted in 1969, Congress recognized that SUB payments "are not subject to [federal income tax] withholding because *they do not constitute wages or remuneration for services.*" S. Rep. No. 91-552, at 255-56 (1969), *reprinted in* 1969 U.S.C.C.A.N. 2027, 2305 (emphasis added). Because SUB payments "are generally taxable income to the recipient," however, Congress decided to require federal income tax withholding on SUB payments to alleviate any unexpected income tax burden on employees for the calendar year in which the payments were made. *Id.* Congress stressed "that *although these benefits are not wages*, since they are generally taxable payments they should be subject to withholding to avoid the final tax payment problem for employees." *Id.* (emphasis added). As a result of the enactment of § 3402(o), the "withholding requirements . . . *on wages* are to apply to these non-wage payments." *Id.* at 2306 (emphasis added).

Because the title and legislative history clarify any ambiguity in the statute, we are convinced that Congress characterized SUB payments as "non-wages" and Congress enacted § 3402(o) simply to extend withholding to these "non-wage" payments to benefit taxpayers. In light of this clear congressional intent, we approve the bankruptcy court's reasoning that if SUB payments are not "wages" but are only treated as if they were "wages" for purposes of federal income tax withholding, then SUB

payments also are not "wages" under the nearly identical definition of that term found in the FICA statute. The analytical bridge for this step in our reasoning arises from the Supreme Court's decision in *Rowan Cos. v. United States*, 452 U.S. 247, 255-57, 101 S. Ct. 2288, 68 L. Ed. 2d 814 (1981).

### C. Application of *Rowan Cos. v. United States*

In *Rowan*, the Supreme Court examined the plain language and legislative history of § 3121(a) and § 3401(a) to conclude that Congress intended the term "wages" to carry the same meaning for purposes of FICA and federal income tax withholding. *Id.* at 257, 101 S. Ct. 2288. By adopting virtually identical definitions of "wages" in the two statutes, Congress expressed an intent to coordinate the two statutory schemes "to promote simplicity and ease of administration." *Id.* The Court said that "[i]t would be extraordinary for a Congress pursuing this interest to intend, without ever saying so, for identical definitions to be interpreted differently." *Id.* Upon concluding that "wages" means the same thing under FICA as it does for federal income tax, the Supreme Court invalidated certain Treasury regulations under which the IRS characterized meals and lodging provided to employees as "wages" under FICA but not as "wages" for purposes of federal income tax withholding. *Id.* at 249-50, 263, 101 S. Ct. 2288.

The government contends that Congress legislatively superseded *Rowan* when it enacted the "decoupling amendment" as part of the Social Security Amendments of 1983, Pub. L. No. 98-21, 97 Stat. 65. Without doubt,

the legislative history of the "decoupling amendment" reveals that Congress believed the objectives of the Social Security system were "significantly different from the objective[s] underlying the income tax withholding rules" and that "amounts exempt from income tax withholding should not be exempt from FICA unless Congress provides an explicit FICA tax exclusion." S. Rep. No. 98-23, at 42 (1983), *reprinted in* 1983 U.S.C.C.A.N. 143, 183. Thus, the legislative history explains, "the determination whether or not amounts are includible in the Social Security wage base is to be made without regard to whether such amounts are treated as wages for income tax withholding purposes. Accordingly, an employee's 'wages' for Social Security tax purposes may be different from the employee's 'wages' for income tax withholding purposes." *Id.* *See also* H.R. Rep. No. 98-25(I), at 80 (1983), *reprinted in* 1983 U.S.C.C.A.N. 219, 299; H.R. Conf. Rep. No. 98-47, at 148 (1983), *reprinted in* 1983 U.S.C.C.A.N. 404, 438.

This statement of congressional intent in the legislative history might change our analysis if Congress had actually passed a statute expressing it. But the actual language Congress used when it enacted the "decoupling amendment" did not achieve its intended effect as expressed in the legislative history. *See CSX Corp. v. United States*, 518 F.3d 1328, 1344 (Fed. Cir. 2008). The decoupling amendment reads:

> Nothing *in the regulations* prescribed for purposes of chapter 24 (relating to income tax withholding) which provides an exclusion from "wages" as used in such chapter shall be construed to require a sim-

> ilar exclusion from "wages" *in the regulations* prescribed for purposes of this chapter [22 relating to FICA]. Except as *otherwise provided in regulations* prescribed by the Secretary, any third party which makes a payment included in wages solely by reason of the parenthetical matter contained in subparagraph (A) of paragraph (2) shall be treated for purposes of this chapter and chapter 22 as the employer with respect to such wages.

I.R.C. § 3121(a) (emphasis added). Thus, "although the committee reports clearly state the intention to decouple the term 'wages' for purposes of income tax withholding and FICA," the statutory language actually "addresses the construction of the regulations." *CSX Corp.*, 518 F.3d at 1344. The decoupling amendment does not provide that "wages" must be treated differently for purposes of federal income tax withholding and FICA; rather, the amendment as written simply allowed the United States Treasury "'to promulgate regulations to provide for different exclusions from "wages" under FICA than under the income tax withholding laws.'" *Id.* (quoting *Anderson v. United States*, 929 F.2d 648, 650 (Fed. Cir. 1991) (also rejecting the government's "decoupling amendment" argument)). Importantly, the Secretary of the Treasury has not promulgated any regulations under the "decoupling amendment." *Id.* Therefore, because the language of the "decoupling amendment" is incongruent with its legislative history, we conclude under a plain reading of the statute that Congress did not statutorily supersede *Rowan* and that the case remains good law.

The government cites several other cases to support its view that the "decoupling amendment" abrogated *Rowan* and that later congressional action to make the "decoupling amendment" retroactive removed any doubt about its impact. *See New England Baptist Hosp. v. United States*, 807 F.2d 280, 284 (1st Cir. 1986); *Canisius Coll. v. United States*, 799 F.2d 18, 21-22 (2d Cir. 1986); *Temple Univ. v. United States*, 769 F.2d 126, 131-33 (3d Cir. 1985); *STA of Balt.–ILA Container Royalty Fund v. United States*, 621 F. Supp. 1567, 1575 (D. Md. 1985), *aff'd*, 804 F.2d 296 (4th Cir. 1986); *Robert Morris Coll. v. United States*, 11 Cl. Ct. 546, 550-52 (1987). These cases do not affect our analysis for two reasons. First, we approvingly cited *Rowan* and its holding long after these cases were decided. *Gerbec v. United States*, 164 F.3d 1015, 1026 n.14 (6th Cir. 1999). Second, these cases failed to focus on the plain meaning of the statute, which, as we have explained, is not in sync with its legislative history, *see CSX Corp.*, 518 F.3d at 1344, and these cases did not address the Secretary's failure to promulgate regulations to implement the "decoupling amendment."

We also do not agree with the government that the Supreme Court eroded *Rowan* when it decided *Environmental Defense v. Duke Energy Corp.*, 549 U.S. 561, 127 S. Ct. 1423, 167 L. Ed. 2d 295 (2007). In *Duke Energy*, the Supreme Court explained that it did not reach its decision in *Rowan* "simply because a 'substantially identical' definition of 'wages' appeared in each of the different statutory provisions." *Id.* at 575, 127 S. Ct. 1423. Instead, the Court "relied on a manifest 'congressional concern for the interest of simplicity and ease of admin-

istration.' The FICA . . . regulations fell for failing to 'serve that interest,' not for defying definitional identity." *Id.* (internal citations omitted). The Supreme Court instructed that "[c]ontext counts," the government argues, because there is no "'effectively irrebuttable' presumption that the same defined term in different provisions of the same statute must 'be interpreted identically.'" *Id.* at 575-76, 127 S. Ct. 1423 (internal citations omitted).

Putting aside that we are not dealing here with the same defined term in different provisions of the same statute, we reject the government's reliance on *Duke Energy* for the same reasons stated by the Federal Circuit in *CSX Corp.*, 518 F.3d at 1344 n.4. While the concern for simplicity and ease of administration "may be less compelling in other statutory settings, such as the one at issue in the *Duke Energy* case, there is nothing in the [Supreme] Court's opinion in [*Duke Energy* ] to suggest that it would take a different view of the relationship between chapter 24 and chapter 21 of the Internal Revenue Code, where the *Rowan* Court found an enhanced need for consistency." *Id.*

We also cannot conclude that *Rowan* was eroded in *Mayo Found. for Med. Educ. & Research v. United States*, — U.S. —, 131 S. Ct. 704, 178 L. Ed. 2d 588 (2011), where the Supreme Court held that stipends paid by the Mayo Foundation to medical residents who worked more than 40 hours per week but also engaged in academic pursuits constituted "wages" under FICA. Applying *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 104 S. Ct. 2778, 81 L. Ed. 2d 694 (1984), the

Supreme Court deferred to a Treasury regulation on the subject. *Mayo Found.*, 131 S. Ct. at 712-13. The government contends that the Supreme Court rejected *Rowan*'s framework for examining the validity of Treasury regulations when it noted that "[s]ince *Rowan* . . . the administrative landscape has changed significantly." *Id.* at 713.

We cannot agree. The aspect of *Rowan* that informs our present analysis is its instruction that the statutory term "wages" should be interpreted consistently in the statutes governing FICA and the federal income tax. The Supreme Court did not address that aspect of *Rowan* in *Mayo Foundation*. Rather, the Court concerned itself with *Rowan*'s status as a pre-*Chevron* case that accorded less deference to a Treasury regulation than is now required under *Chevron*. *Id.* at 713-14. *Mayo Foundation* adds nothing of significance to our legal analysis.

The government argues that, even if *Rowan* remains good law, the result reached by the bankruptcy court in favor of Quality Stores is inconsistent with the thrust of *Rowan*. While the Supreme Court construed the FICA and income tax definitions of "wages" similarly in order to effectuate a congressional intent to promote "simplicity and ease of administration," *Rowan*, 452 U.S. at 257, 101 S. Ct. 2288, here, the government argues, the bankruptcy court's decision results in different treatment of SUB payments for purposes of FICA and income-tax withholding, which is precisely the situation *Rowan* sought to avoid.

This argument misses the target. Congress imposed federal income tax withholding on SUB payments because they qualify as gross income, not because they are "wages." Reading the definitions of "wages" found in the FICA and federal income tax statutes consistently, SUB payments do not constitute "wages" under either statutory scheme.

*Rowan* remains good law, and the Federal Circuit agrees with us on this point. *CSX Corp.*, 518 F.3d at 1344 & n.4. That court, however, confined the congressional definition of SUB pay in I.R.C. § 3402(*o*) to federal income tax withholding only and did not rely on *Rowan* to conclude that the same statutory definition applies to FICA tax. *Id.* at 1340-42, 1345. In doing so, the Federal Circuit appears to have created an inconsistency within its own law. *Id.* at 1344 (observing that *Anderson v. United States*, 929 F.2d 648 (Fed. Cir. 1991), "held that the term 'including benefits' in the definition of wages under FICA must be accorded the same meaning as the identical term used in the income tax statutes.") By contrast to the analysis of the Federal Circuit, we rely on *Rowan* to reach the conclusion that if Congress decided to treat SUB payments as if they were "wages" for purposes of federal income tax withholding, then the same definition must apply under FICA.

**D. Summary**

Accordingly, we conclude, under the stipulated facts of this case, that the payments Quality Stores made to its employees pursuant to the Pre-and Post-Petition Plans qualify as SUB payments under I.R.C. § 3402(*o*). Be-

cause Congress has provided that SUB payments are not "wages" and are treated only as if they were "wages" for purposes of federal income tax withholding, such payments are not "wages" for purposes of FICA taxation.[4] We are cognizant of our prior decision construing payments made to teachers in exchange for relinquishment of their statutory tenure rights as "wages" taxable under

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[4] Other subsections of the statute allow federal withholding with respect to certain payments made to employees for annuities and sick pay. I.R.C. § 3402(*o*)(1)(B) & (C). The government argues it was unnecessary for Congress to exclude annuity payments and sick pay from the FICA definition of "wages" if, under I.R.C. § 3402(*o*), those payments were already considered non-wage payments for FICA purposes.

The bankruptcy court responded to this argument by noting that "the reason for these exclusions is explained by the disparate nature of the types of payments." *In re Quality Stores, Inc.*, 383 B.R. at 76. For instance, annuity payments are considered "remuneration for services" and thus are deemed to be "wages" for both FICA and federal income tax withholding, but Congress specifically excluded annuity payments from the definition of "wages" under chapters 21 (FICA) and 24 (federal income tax) of the Tax Code. *See* I.R.C. §§ 3121(a)(5)(B), 3401(a)(12)(B). By enacting § 3402(*o*), the court reasoned, Congress gave employees the option to request federal income tax withholding on annuity payments to avoid an unexpectedly large income tax bill. By contrast, SUB payments are not "remuneration for services," so such payments do not initially fall within the statutory definition of "wages." Therefore, there was no need for Congress to specifically exclude them from FICA tax, yet federal income taxpayers were provided the same option for federal income tax withholding. *In re Quality Stores, Inc.*, 383 B.R. at 76. The same analysis applies to sick pay. *Id.*

In light of *Coffy* and our entire analysis, we adopt the bankruptcy court's reasoning on this point.

FICA, *Appoloni*, 450 F.3d at 196, but in that case we did not examine the meaning of SUB pay or the interpretation of I.R.C. § 3402(*o*). Nor did we examine those issues in *Gerbec*, 164 F.3d at 1026, where we held that certain awards representing lost back pay and future wages amounted to compensation paid to the employee because of the employer-employee relationship and thus were taxable under FICA. We have also considered our prior holding that payments employees received from the residual balance of a terminated supplemental employment benefit trust fund constituted "wages" for the purpose of the FICA tax because they were solely derived from employer contributions and were contingent on past or present employment. *Sheet Metal Workers Local 141 Supplemental Unemployment Benefit Trust Fund v. United States*, 64 F.3d 245, 250-51 (6th Cir. 1995). In that case, the fund did not argue that the residual balance payments "were supplemental unemployment benefits which are exempt from FICA" tax. *Id.* at 251 n.4. Therefore, these prior cases do not impact our analysis here.

### E. IRS Revenue Rulings Conflict With Congressional Intent

Having detailed the reasons why we affirm the bankruptcy court, we also explain why we do not adopt the government's other arguments or follow the IRS revenue rulings the government cites. In many respects, we find the arguments and revenue rulings to be inconsistent with the intent of Congress as expressed in the statutes and the legislative history as discussed above.

The government argues that, prior to 1950 when SUB pay had not yet been conceived, "dismissal pay" was specifically excluded from the definition of "wages" under FICA, Social Security Act Amendments of 1939, Pub. L. No. 76-379, ch. 666, 53 Stat. 1360, 1384, codified at I.R.C. § 1426(a)(4) (1939 Code), and Congress repealed the exclusion for "dismissal pay" in the Social Security Act Amendments of 1949, thus making all "dismissal pay" subject to FICA tax, *see* Pub. L. No. 81-734, ch. 809, 64 Stat. 477. The Federal Circuit adopted the government's position, *see CSX Corp.*, 518 F.3d at 1334, but we do not agree with the government's historical assessment of the law.

Prior to 1950, most "dismissal pay" was *not* excluded from the FICA definition of "wages." Only a small category—those payments an employer was not legally required to make—was excluded. S. Rep. No. 76-734, at 54 (1939) (accompanying H.R. 6635, amending the Social Security Act). The Social Security Act Amendments of 1949 eliminated the exclusion for "dismissal payments" an employer was not legally required to make:

> Section 1426(a) as amended by the bill contains no provision comparable to paragraph (4) of existing law which excludes from the term "wages" dismissal payments which the employer is not legally required to make. Therefore, a dismissal payment, which is any payment made by an employer on account of involuntary separation of the employee from the service of the employer, will constitute wages . . . irrespective of whether the

> employer is, or is not, legally required to make such payment.

H.R. Rep. No. 1300, at 124 (1949). In any event, we agree that at the time SUB pay was conceived in the 1950s, all "dismissal payments" made to employees qualified as FICA "wages" for purposes of taxation.

When employers began adopting plans under collective bargaining agreements to fund trusts for the purpose of making SUB payments to employees in the event of unexpected job lay-off or termination, it was critical that SUB payments not be characterized as "wages." If SUB payments constituted "wages," then unemployed workers could not qualify for unemployment benefits under most states' laws, and the unavailability of unemployment benefits would largely defeat the purpose of SUB payments. Employers thus sought the guidance of the IRS to determine whether payments from their SUB plans would be characterized as taxable "wages."

In 1956, based on the specific facts of the employer plan before it, the IRS determined that SUB payments did not constitute "wages" for purposes of taxation under FICA and the Federal Unemployment Tax Act ("FUTA") because eight elements were met: (1) the benefits were paid only to unemployed former employees who were laid off by the employer; (2) eligibility for benefits depended on meeting prescribed conditions after employment terminated; (3) benefits were paid by trustees of independent trusts; (4) the amount of weekly benefits payable was based on state unemployment benefits, other compensation allowed under state unemployment laws, and

the amount of straight-time weekly pay after withholding all taxes and contributions; (5) the duration of the benefits was affected by the fund level and the employee's seniority; (6) the right to benefits did not accrue until a prescribed period after termination of employment; (7) the benefits were not attributable to the rendering of any particular services; and (8) no employee had any right, title, or interest in the fund until such employee was qualified and eligible to receive benefits. Rev. Rul. 56-249, 1956-1 C.B. 488. The IRS ruled, however, that even SUB payments meeting this definition must still be included in the gross income of the recipient for federal income tax purposes.[5] *Id.*

The IRS subsequently considered a SUB plan that was unilaterally instituted by the employer without union negotiation, Rev. Rul. 58-128, 1958-1 C.B. 89, and a SUB plan that allowed the employer to pay benefits to employees directly without use of a separate trust, Rev. Rul. 60-330, 1960-2 C.B. 46. In both situations, the IRS ruled that the SUB payments were excluded from FICA "wages" because the plans were otherwise similar in all material respects to the plan evaluated in Rev. Rul. 56-249. The IRS also ruled that the same principles applied if lump sum payments were made, rather than payments over a period of time. Rev. Rul. 59-227, 1959-2 C.B. 13.

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[5] There are substantial differences in the IRS eight-part test and the five-part test Congress later adopted, as discussed previously in this opinion.

In 1960, Congress amended the Internal Revenue Code to provide an income-tax exemption for SUB trusts. Pub. L. No. 86-667, 74 Stat. 534 (1960). In doing so, Congress defined SUB pay as "benefits which are paid to an employee because of his involuntary separation from the employment of the employer (whether or not such separation is temporary) resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions . . . ." 74 Stat. 535. This definition remains in the statute today, I.R.C. § 501(c)(17), and it closely mirrors the SUB pay definition Congress later added to the federal income tax withholding statute in 1969, as discussed earlier in this opinion. I.R.C. § 3402(*o*)(2)(A). Because Congress knew that employers had developed a variety of SUB plans, it wished to facilitate the tax-exempt status of SUB plans because they provide "worthwhile benefits, but at the same time are not in competition with profit-making enterprises." S. Rep. No. 86-1518 (1960), *reprinted in* 1960 U.S.C.C.A.N. 3203, 3205.

In 1971, after Congress added its own definitions of SUB pay to § 501(c)(17) and § 3402(*o*)(2)(A), the IRS issued another revenue ruling in which it considered an agreement between an employer and a union under which the employer made awards to employees who were separated from service based on the employees' rate of pay and years of service. Relying on the "dismissal payment" amendment to the Social Security Act that took effect in 1950 and the "dismissal payment" regulation in the federal income tax withholding regulations, Treas. Reg. § 31.3401(a)-1(b)(4), the IRS determined that the

"dismissal payments" constituted taxable "wages" under FICA.[6] Rev. Rul. 71-408, 1971-2 C.B. 340. Soon thereafter, the IRS reached the same conclusion in addressing a "dismissal payment" where the employer and the employee had contractually agreed that the employer would make "dismissal payments" if the employer terminated the employee early. Rev. Rul. 74-252, 1974-1 C.B. 287.

In 1977, the IRS determined that a SUB plan, although not directly tied to the receipt of state unemployment compensation benefits, was substantially the same as the plan discussed in Rev. Rul. 56-249. Rev. Rul. 77-347, 1977-2 C.B. 362. Because the payments made under that plan did not disqualify the employees from receiving state unemployment benefits, the IRS found that the payments were SUB payments as defined by Congress in § 3402(*o*) and were not subject to FICA tax. The IRS modified and amplified Rev. Rul. 56-249 and Rev. Rul. 58-128 to reflect the change in the Tax Code that Congress effectuated in 1969 when it enacted § 3402(*o*). Thus, Rev. Rul. 77-347 is consistent with both our conclusion and that of the bankruptcy court that because SUB payments are not "wages" and are only treated as if they were "wages" under § 3402(*o*), SUB payments also are not "wages" under FICA.

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[6] Treasury Regulation § 31.3401(a)-1(b)(4) provides that "dismissal payments" are "[a]ny payments made by an employer to an employee on account of dismissal, that is, involuntary separation from the service of the employer, [which] constitute wages regardless of whether the employer is legally bound by contract, statute, or otherwise to make such payments."

The IRS later reversed itself on this point, however, stating that the "definition of SUB pay under section 3402(*o*) is not applicable for FICA. . . . SUB pay is defined solely through a series of administrative pronouncements published by the Service." Rev. Rul. 90-72, 1990-2 C.B. 211. To be exempt from "wages" under FICA, the IRS reasoned, SUB payments must be made to involuntarily separated employees pursuant to a plan that is designed to supplement the receipt of state unemployment compensation. *Id.* Moreover, the IRS ruled that payments in a lump sum are not considered linked to state unemployment compensation and therefore are not excludable from FICA "wages." *Id.* The IRS specified that it issued the ruling to "restore[ ] the distinction between SUB pay and dismissal pay by re-establishing the link between SUB pay and state unemployment compensation set forth in Rev. Rul. 56-249." *Id.*

In *CSX Corp.*, 518 F.3d at 1346, the Federal Circuit adopted the IRS's eight-part administrative definition of SUB pay set out in Rev. Rul. No. 56-249 and Rev. Rul. 90-72 rather than the express statutory definition provided by Congress in § 3402(*o*). That court characterized the payments before it as "dismissal pay" subject to FICA tax. *Id.*

By contrast, we resolve the tension between the statutory enactments and the IRS revenue rulings in favor of the expressed will of the legislature. Applying the five-part definition that Congress enacted in § 3402(*o*)(2)(A), the payments made by Quality Stores to its former employees qualify as SUB payments, not "dismissal pay."

And as we have explained, SUB payments are not subject to FICA tax.

We decline to imbue the IRS revenue rulings and private letter rulings with greater significance than the congressional intent expressed in the applicable statutes and legislative histories. Congress, not the IRS, prescribes the tax laws; IRS revenue rulings "have only such force as Congress chooses to give them, and Congress has not given them the force of law." *Dixon v. United States*, 381 U.S. 68, 73, 85 S. Ct. 1301, 14 L. Ed. 2d 223 (1965); *Aeroquip-Vickers, Inc. v. Comm'r of Internal Revenue*, 347 F.3d 173, 181 (6th Cir. 2003) (observing we do not give *Chevron* deference to revenue rulings because "the IRS does not invoke its authority to make rules with the force of law"). The power of the IRS to "administer a federal statute and to prescribe rules and regulations to that end is not the power to make law . . . but the power to adopt regulations to carry into effect the will of Congress as expressed by the statute." *Dixon*, 381 U.S. at 74, 85 S. Ct. 1301. The rights of the taxpayer are defined by the statute, which establishes the standard by which such rights must be measured. *Id.* And where a promulgated Treasury regulation has no power to alter a statute Congress enacted, neither does a revenue ruling. *See id.* at 75, 85 S. Ct. 1301. In appropriate circumstances we may give substantial judicial deference to longstanding and reasonable interpretations of IRS regulations and revenue rulings, *Envtl. Def.*, 549 U.S. at 575, 127 S. Ct. 1423, but in this case we conclude, for all the reasons we have discussed, that the IRS has not taken congressional intent fully into account.

## IV. CONCLUSION

We agree with the Federal Circuit on one final important point: "We acknowledge that this issue of statutory construction is complex and that the correct resolution of the issue is far from obvious." *CSX Corp.*, 518 F.3d at 1340. While the Supreme Court may ultimately provide us with the correct resolution of these difficult issues under the law as it currently stands, only Congress can clarify the statutes concerning the imposition of FICA tax on SUB payments. Our role is to interpret the statutory law as it presently exists, and we have done that today. Accordingly, the judgment of the district court is AFFIRMED.

## APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

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No. 10-1563

IN RE QUALITY STORES, INC., ET AL., DEBTORS
UNITED STATES OF AMERICA, APPELLANT

*v.*

QUALITY STORES, INC., ET AL., APPELLEES

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[Filed: Jan. 4, 2013]

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**ORDER**

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Before: BOGGS and STRANCH, Circuit Judges; and CARR,* District Judge.

The court having received a petition for rehearing en banc, and the petition having been circulated not only to the original panel members but also to all other active judges of this court, and no judge of this court having requested a vote on the suggestion for rehear-

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* Hon. James G. Carr, Senior United States District Judge for the Northern District of Ohio, sitting by designation.

ing en banc, the petition for rehearing has been referred to the original panel.

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.

## APPENDIX C

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

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No. 1:09-CV-44

IN RE QUALITY STORES, INC., ET AL., DEBTORS
UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

*v.*

QUALITY STORES, INC., ET AL., PLAINTIFFS-APPELLEES

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Filed: Feb. 23, 2010

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## OPINION

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JANET T. NEFF, District Judge.

This matter is before the Court on appeal from the Bankruptcy Court. Plaintiffs ("Quality Stores") commenced this adversary proceeding against defendant United States, seeking the refund of $1,000,125 in Federal Insurance Contributions Act[1] (FICA) taxes paid with regard to severance payments to former employees. The Bankruptcy Court, the Honorable James D.

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[1] 26 U.S.C. §§ 3101-3128.

Gregg, entered a final judgment in favor of plaintiffs, determining that the payments made to the employees pursuant to the severance programs were not "wages" for purposes of FICA taxation. *See Quality Stores, Inc., v. United States* (*In re Quality Stores, Inc.*), 383 B.R. 67 (Bankr. W.D. Mich. 2008). The United States appeals that decision.

## I. Facts

This case was submitted to the Bankruptcy Court on stipulated facts ("Stip.Facts") for purposes of the parties' cross-motions for summary judgment. The facts, as set forth by the Bankruptcy Court, are not disputed on appeal:

> [T]he Debtors operated a chain of retail stores specializing in agricultural supplies and related products. During the period preceding the bankruptcy cases (the "Prepetition Period"), the Debtors were forced to close approximately sixty-three stores and nine distribution centers. The Debtors also terminated approximately seventy-five employees at their corporate office during the Prepetition Period.
>
> On October 20, 2001, an involuntary chapter 11 petition was filed against the Debtors. Quality Stores, Inc., answered the involuntary petition and consented to the entry of an order for relief on November 1, 2001. The remaining Debtors also commenced voluntary chapter 11 cases on November 1, 2001. After the petition date (the "Postpetition Period"), the Debtors closed their remaining 311

stores and three distribution centers. The Debtors also terminated all of their remaining employees.

The Debtors made severance payments to employees who were terminated during both the Prepetition and Postpetition Periods. The parties agree that the severance payments were made "pursuant to [severance plans] maintained by the Debtors." (Stip. Facts ¶ 15.) The parties further stipulate that the severance payments were made "because of the employees' involuntary separation from employment," which resulted "directly from a reduction in force or the discontinuance of a plant or operation." (Stip. Facts ¶ 15.) The severance payments were included in the employees' gross income, and the Debtors reported the severance payments as wages on the W–2 forms issued to employees. The Debtors withheld federal income tax and the employees' share of FICA tax from the severance payments. The Debtors also paid the employer's share of FICA tax with respect to the severance payments.

Under the Prepetition Severance Plan, the Debtors' senior executives received twelve to eighteen months of severance pay. All other employees received one week of severance pay for each full year of service. These payments were not connected to the receipt of state unemployment compensation and were not attributable to the rendering of any particular employment service. The severance payments were paid on a weekly or semi-weekly

basis, in accordance with the Debtors' normal payroll period. Approximately $382,362 of the total refund requested in this adversary proceeding is attributable to severance payments made under the Prepetition Severance Plan.

Under the Postpetition Severance Plan, officers received six to twelve months of severance pay. Full-time salaried and hourly employees who had been employed for at least two years received one week of severance pay for each full year of service, up to a maximum of ten weeks for salaried employees and five weeks for hourly employees. Employees who had worked for the Debtors for less than two years received one week of severance pay, and the approximately 900 employees who were subsequently employed by the companies who purchased the Debtors' assets did not receive any severance pay. Like the prepetition severance payments, the postpetition payments were not connected to the receipt of state unemployment compensation and were not attributable to the rendering of any particular employment services. All severance payments for the Postpetition Period were paid in a lump sum. Approximately $617,763 of the total refund requested in this adversary proceeding is attributable to payments made under the Postpetition Severance Plan.

On September 17, 2002, the Debtors filed fifteen separate refund claims with the IRS, seeking to re-

cover $1,000,125 in allegedly overpaid FICA taxes.[2] On June 1, 2005, the Debtors filed this adversary proceeding. The Debtors' complaint seeks to compel the IRS to turn over the alleged overpaid FICA taxes, plus interest, as property of the Debtors' bankruptcy estate. Because the issue presented in this adversary proceeding is a purely legal question, the parties filed stipulated facts and cross motions for summary judgment. Legal memoranda were filed, oral argument was held, and the court took the matter under advisement.

## II. Issue and Legal Rulings

This case presents a straightforward, but legally-confounding question: whether severance payments qualify as "wages" subject to FICA taxation. As framed by the United States, the more specific issue is whether the debtor is liable for FICA taxes on payments to employees upon their termination of employment because of the downsizing and subsequent closing of operations by their employer, even though the payments are not connected to or contingent on the recipients' eligibility for state unemployment compensation benefits (Def. Br. 7).

The few courts that have addressed this issue, or variations of it, have reached directly opposing outcomes. Where one court has found severance pay-

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[2] This amount includes the employer's share of FICA taxes paid by the Debtors and the employees' share of FICA taxes for those employees who consented to permit the Debtors to make the refund request on their behalf.

ments to be subject to taxation, the next has reached the opposite conclusion. The fact that the Internal Revenue Service has itself charted a path of "reverse-course" rulings on this issue since the 1950s only adds to the difficulties faced by the courts in attempting to reach a reasoned resolution by explaining and accounting for this repeated change in agency position.

To say that these differing rulings are simply the product of results-oriented decision-making is tempting, but unsupportable. The courts have not only diligently wrestled with the justification for their conclusions, but also endeavored to fashion some appropriate, logical framework for the analysis of this issue.

After a thorough consideration of the parties' arguments, the Bankruptcy Court concluded that the severance payments made to the employees pursuant to the Pre- and Postpetition Severance programs were not "wages" for purposes of FICA taxation. *Quality Stores*, 383 B.R. at 78. The Bankruptcy Court relied in part on the analysis and resolution of this same legal question by the Federal Court of Claims in *CSX Corp., Inc. v. United States*, 52 Fed. Cl. 208 (Fed. Cl. 2002). After the decision by the Bankruptcy Court, however, the United States Court of Appeals for the Federal Circuit reversed, in key part, the lower court's decision in *CSX*. *See CSX Corp. v. United States*, 518 F.3d 1328 (Fed. Cir. 2008). Given the reversal, the United States moved for reconsideration of the Bankruptcy Court's decision in this case. The Bankruptcy Court granted the motion for reconsideration, and on reconsideration, ratified its prior opinion and order.

Having now the benefit of these courts' prior efforts and analysis, this Court concludes that the severance payments at issue are not properly classified as "wages," and therefore, are not subject to FICA taxation. Accordingly, the decision of the Bankruptcy Court is affirmed.

## III. Standard of Review

This case was before the Bankruptcy Court on the parties' cross-motions for summary judgment. The Bankruptcy Court granted summary judgment in favor of Quality Stores. On appeal to this Court from a bankruptcy court's final order or judgment, the bankruptcy court's conclusions of law are reviewed de novo. *Pierce v. Underwood*, 487 U.S. 552, 557-58, 108 S. Ct. 2541, 101 L. Ed. 2d 490 (1988); *In re Rowell*, 359 F. Supp. 2d 645, 647 (W.D. Mich. 2004). Issues of statutory interpretation are questions of law, and are thus subject to review de novo. *ITT Indus. v. Borg-Warner, Inc.*, 506 F.3d 452, 457 (6th Cir. 2007). The district court may affirm, modify, or reverse a bankruptcy judge's judgment, order, or decree or remand with instructions for further proceedings. FED. R. BANKR. P. 8013.

Federal Rule of Civil Procedure 56 governs summary judgment in bankruptcy court adversary proceedings. FED. R. BANKR. P. 7056; *In re Rowell*, 359 F. Supp. 2d at 647. Thus, the motion for summary judgment is properly granted "if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any

material fact and that the movant is entitled to judgment as a matter of law." FED. R. CIV. P. 56(c).

## IV. Analysis

The essential issue presented is whether the severance payments to employees/former employees of Quality Stores constitute taxable "wages" for purposes of FICA. There is no dispute that if the severance payments constitute "wages" for purposes of FICA, and if there is no applicable exception, then the severance payments are subject to FICA taxation, and neither Quality Stores nor the employees is entitled to a refund of the FICA taxes paid.

### A. FICA Wages and Exceptions

#### 1. Statutory Provisions

The United States contends that the severance payments at issue are "wages" for purposes of FICA and that no statutory exception applies to exclude them from taxation. Further, the payments do not qualify under the "supplemental unemployment benefits" exception set forth in guidance from the Internal Revenue Service because the severance payments were not conditioned on eligibility for or receipt of state unemployment benefits. *See* Rev. Rul. 90-72, 1990-2 C.B. 211; Rev. Rul. 56-249, 1956-1 C.B. 488. The United States contends therefore, that as a matter of law, the severance payments are subject to FICA taxation, and statutory provisions concerning the withholding of income tax under 26 U.S.C. § 3402(*o*) cannot be relied on

to except the payments from the broad definition of wages under FICA.

"FICA, codified in Chapter 21 of the Internal Revenue Code, Sections 3101 through 3128, imposes a tax upon the wages of employees to fund Social Security and Medicare Benefits." *Appoloni v. United States*, 450 F.3d 185, 189 (6th Cir. 2006). For purposes of FICA, "wages" are defined as "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash." 26 U.S.C. § 3121(a); *Appoloni*, 450 F.3d at 189-90. "Employment" is defined as "any service, of whatever nature, performed [] by an employee for the person employing him. . . . " 26 U.S.C. § 3121(b).

Section 3121 sets forth statutory exceptions to FICA's broad definition of wages, none of which are at issue here. However, the Internal Revenue Service has also published guidance based on its interpretation of the statute, which provides an exception to FICA for certain payments made by an employer, conditioned on eligibility for and receipt of state unemployment benefits, referred to as "supplemental unemployment compensation benefits," or "SUB" pay. It is this agency exception that is the United States' argument.

2. Revenue Rulings

In a series of revenue rulings from 1956 to 1990, the IRS addressed whether payments from severance plans purporting to be SUB plans constituted "wages" under Chapter 21 (FLCA) and Chapter 24 (income tax

withholding) of the Internal Revenue Code. *See CSX Corp.*, 518 F.3d at 1334-40 (detailing the chronology and nature of the various rulings). Over the course of these rulings, the IRS has reversed its position on the tax treatment of supplemental unemployment compensation benefits.

"In 1956, the Internal Revenue Service issued a revenue ruling, Rev. Rul. 56-249, 1956-1 C.B. 488, in which the IRS took the position with respect to a particular SUB plan that SUB payments under that plan would not be considered 'wages' for purposes of FICA" *CSX Corp.*, 518 F.3d at 1335. The IRS issued additional rulings over the next several years. *Id.* In 1977, the IRS issued a revenue ruling dealing with SUB payments, again specifically determining that SUB payments were not "wages" for purposes of FICA and FUTA. *Id.* at 1337-38. "During the years between 1977 and 1990, the IRS issued a number of private letter rulings in which it approved various SUB plans, authorizing the employers to treat the SUB payments under those plans as non-wages." *Id.* at 1339. In 1989, the IRS announced that it would cease the issuance of private letter rulings concerning SUB payments pending further review of the issue. *Id.*

In 1990, the IRS issued Rev. Rul. 90-72. In this most recent guidance, the IRS concluded that SUB pay must be linked to the receipt of state unemployment compensation and must not be received in a lump sum in order to be excludable from the definition of wages for purposes of FICA taxation and federal income tax withholding. Rev. Rul. 90-72, 1990-2 C.B.

211; *CSX Corp.*, 518 F.3d at 1339-40. "The IRS characterized Rev. Rul. 90-72 as 'restor[ing] the distinction between SUB pay and dismissal pay by re-establishing the link between SUB pay and state unemployment compensation' originally established in Rev. Rul. 56-249, 1990-2 C.B. at 213. As such, the 1990 revenue ruling stated that it was modifying the 1977 revenue ruling to the extent that the earlier ruling had allowed payments to qualify as SUB for purposes of FICA even when the payments were not tied to eligibility for state unemployment compensation." *CSX Corp.*, 518 F.3d at 1340.

3. 26 U.S.C. § 3402(*o*)

"During the 1960s, SUB payments were treated, for income tax purposes, as ordinary income to the recipient, but not as wages for purposes of either the income tax withholding statutes or FICA." *CSX Corp.*, 518 F.3d at 1336. Because SUB pay was not automatically subject to taxation as wages, and therefore, income tax withholding, employees who received SUB payments often encountered large income tax obligations at the end of the taxable year. *Id.* In 1969, at the request of the Treasury Department, Congress amended Chapter 24 of the Internal Revenue Code (income tax withholding statutes) to solve the problem of 'under withholding' faced by taxpayers who received SUB pay. *Id.* The new tax withholding provision, 26 U.S.C. § 3402(*o*), ensured that SUB payments that were not deemed wages would be subject to income tax withholding by the employer. *Id.*

Section 3402(*o*) provides for income tax withholding on certain payments other than wages, including "any supplemental unemployment compensation," and certain annuity payments and sick pay. At the time of the enactment of § 3402(*o*), the Senate Committee report recognized that SUB payments were not subject to income tax withholding because "'because they do not constitute wages or remuneration for services.'" *CSX Corp.*, 518 F.3d at 1336-37 (quoting S. Rep. No. 91-552, at 268 (1969), *as reprinted in* 1969 U.S.C.C.A.N. 2007, 2305). Accordingly, the amendment added language expressly stating the SUB payments "shall be treated as if it were a payment of wages by an employer to an employee for a payroll period."

Section 3402(*o*) provides:

> 1. General rule.—For purposes of this chapter (and so much of subtitle F as relates to this chapter)—
>
> (A) any supplemental unemployment compensation benefit paid to an individual,
>
> (B) any payment of an annuity to an individual, if at the time the payment is made a request that such annuity be subject to withholding under this chapter is in effect, and
>
> (C) any payment to an individual of sick pay which does not constitute wages (determined without regard to this subsection), if at the time the payment is made a request that such sick pay be subject to withholding under this chapter is in effect,

> shall be treated as if it were a payment of wages by an employer to an employee for a payroll period.

For purposes of paragraph (1), § 3402(*o*) defines "supplemental unemployment compensation benefits" as:

> amounts which are paid to an employee, pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment (whether or not such separation is temporary), resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, but only to the extent such benefits are includible in the employee's gross income.

26 U.S.C. § 3402(*o*)(2)(A).

Although § 3402(*o*) is contained within the income tax withholding statutes, it arguably informs the determination whether SUB payments are "wages" for purposes of FICA tax. "Congress chose 'wages' as the base for measuring employers' obligations under FICA, FUTA, and income-tax withholding."[2] *Rowan*

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[2] "Congress defined 'wages' identically in FICA and FUTA, as 'all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash.'" §§ 3121(a) (FICA), 3306(b) (FUTA). For the purpose of income-tax withholding, "Congress defined 'wages' as 'all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash.' § 3401(a)." *Rowan*, 452 U.S. at 250 n.4, 101 S. Ct. 2288.

*Cos., Inc. v. United States*, 452 U.S. 247, 254, 101 S. Ct. 2288, 68 L. Ed. 2d 814 (1981). In rowan, the Court considered whether Congress intended the term "wages" to have the same meaning for purposes of FICA, FUTA, and income-tax withholding. *Id.* at 254-55, 101 S. Ct. 2288. The Court observed that from an historic perspective, these Acts "reveal a congressional concern for 'the interest of simplicity and ease of administration.'" *Id.* at 255, 101 S. Ct. 2288 (quoting S. Rep. No. 1631, 77th Cong., 2d Sess., 165 (1942) (revenue Act of 1942)). The Court reasoned that Congress chose to base income tax withholding on the same measure, "wages," as taxation under FICA and FUTA, and specified that remuneration for certain services was excepted from "wages." *Id.* at 255-56, 101 S. Ct. 2288.

Consequently, the *Rowan* Court rejected as invalid Treasury Regulations that did not implement the statutory definition of "wages" in a consistent or reasonable manner. *Rowan*, 452 U.S. at 263, 101 S. Ct. 2288. "The plain language and legislative histories of the relevant Acts indicate that Congress intended its definition to be interpreted in the same manner for FICA and FUTA as for income-tax withholding." *Id.*

4. Decoupling Amendment

Following the decision in *Rowan*, Congress amended the Internal Revenue Code to add language to § 3121(a), often referred to as the "decoupling amendment," to allow for regulatory distinctions between ex-

clusions in "wages" for income tax withholding and other taxation purposes:

> Nothing in the regulations prescribed for purposes of chapter 24 (relating to income tax withholding) which provides an exclusion from "wages" as used in such chapter shall be construed to require a similar exclusion from "wages" in the regulations prescribed for purposes of this chapter. . . .

26 U.S.C. § 3121(a).

There is no dispute that the decoupling amendment applies to this case; however, the parties point to no regulations that have been promulgated to distinguish between the "wage" exclusions under consideration. Instead, the parties dispute whether, in light of the decoupling amendment, the reasoning in *Rowan*, remains controlling.

B. Application

The United States argues that the payments made by Quality Stores to its employees are within the scope of § 3121 because the payments were made in connection with employment and were not conditioned on eligibility for state unemployment benefits as required under the exception set forth in Rev. Rul. 90-72. To the contrary, Quality Stores contends that SUB payments are not wages for income tax withholding purposes because they are not "remuneration for services," and they do not constitute wages for FICA taxation purposes because they are not "remuneration for service performed by an employee" (Pls. Br. 14). Instead, relying on § 3402(*o*), Quality Stores contends

that for income tax withholding purposes, SUB payments are treated *as if they are wages*; thus, the Bankruptcy Court correctly held that the Severance Payments were not subject to FICA taxation.

As the Federal Circuit Court observed in *CSX*, "this issue of statutory construction is complex and [ ] the correct resolution of the issue is far from obvious." *CSX Corp.*, 518 F.3d at 1340. With all due respect to the Federal Circuit and its consideration of the issues, this Court is persuaded that the Bankruptcy Court was correct in rejecting the Federal Circuit's result in this case. Quality Stores' analysis of the issues is convincing, and a contrary result can only be reached by a strained construction of statutes at issue.

As a general matter, "[i]n enacting the FICA provisions, Congress intended to impose FICA taxes on a broad range of employer-furnished remuneration in order to accomplish the remedial purpose of the Social Security Act." *Associated Elec. Coop., Inc. v. United States*, 226 F.3d 1322, 1326 (Fed. Cir. 2000). Nonetheless, this purpose is not unlimited. The statutory enactments make clear that at some point a line is to be drawn on the taxation of employee financial benefits; otherwise, the benefits become the basis of the very taxes collected to return as benefits. That is, at one end of the spectrum are social security benefits and at the other end of the spectrum are wages/earnings, and at the point on the spectrum where severance payments are intended to serve the same purpose as social security benefits, i.e., support for workers in lieu of a lost ability to earn wages, the collection

of social benefit taxes on the wage-replacement benefits makes little sense.

Only when the morass of seeming complex statutory enactments and regulations is considered in these terms do the taxation provisions become a coherent system anchored to the primary purpose of wage-replacement and social benefits. Having considered the parties' arguments and applied the statutory analysis in these terms, this Court is persuaded that the severance payments at issue are properly viewed as wage-replacement social benefits, not taxable remuneration for the employees' services or wages. Therefore, the severance payments are not subject to taxation for FICA purposes.

For purposes of FICA, "wages" are defined as "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash." 26 U.S.C. § 3121(a); *Appoloni*, 450 F.3d at 189-90. "Employment" is defined as "any service, of whatever nature, performed [ ] by an employee for the person employing him. . . . " 26 U.S.C. § 3121(b). However, under § 3402(*o*), "any supplemental unemployment compensation" is specifically excluded from the definition of "wages" for tax withholding purposes. As noted above, at the time of the enactment of § 3402(*o*), the Senate Committee report recognized that SUB payments were not subject to income tax withholding because "'because they do not constitute wages or remuneration for services.'" *CSX Corp.*, 518 F.3d at 1336-37.

Section 3402(*o*) defines "supplemental unemployment compensation benefits" as:

> amounts which are paid to an employee, pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment (whether or not such separation is temporary), resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, but only to the extent such benefits are includible in the employees gross income.

26 U.S.C. § 3402(*o*)(2)(A). Section 3402(*o*) expressly provides that supplemental unemployment compensation benefits, SUB pay, "shall be treated as if it were a payment of wages by an employer to an employee for a payroll period." 26 U.S.C. § 3402(*o*)(1).

The severance payments in this case meet the definition of "supplemental unemployment compensation benefits" in § 3402(*o*)(2). Contrary to the United States' argument, this Court finds no basis for concluding that § 3402(*o*) does not control the determination whether the severance payments at issue in this case are taxable for purposes of FICA. The reasoning in *Rowan* is instructive on this issue. The statutory definition of "wages" must be applied in a consistent or reasonable manner. *Rowan*, 452 U.S. at 263, 101 S. Ct. 2288. There is no justification for differing interpretations of "wages" under FICA and the income tax withholding statutes.

Although following *Rowan*, Congress has provided for regulatory distinctions in "wages," pursuant to the

decoupling amendment, no such regulations have been promulgated to distinguish between the "wage" exclusions under consideration. As Quality Stores points out, Revenue Rulings do not have the effect of regulations. Thus, the Revenue Rulings, and in particular Rev. Rul. 90-72, relied on by the United States do not, pursuant to the decoupling amendment, mandate differing treatment of supplemental unemployment compensation benefits under FICA and the income tax withholding statutes, i.e., § 3402(*o*). Accordingly, despite the decoupling amendment, the reasoning in *Rowan* remains controlling, and Rev. Rul. 90-72 does not override the specific provisions of § 3402(*o*).

> Having determined that § 3402(*o*) properly guides consideration of the severance payments in this case, the Court briefly addresses the Federal Circuit decision in *CSX* in which the court dismissed § 3402(*o*) as ultimately having no bearing on treatment of severance payments. *CSX Corp.*, 518 F.3d at 1341-42. The Federal Circuit concluded that the language in § 3402(*o*) expressly stating that SUB pay "shall be treated *as if it were a payment of wages* by an employer to an employee for a payroll period" does not necessarily imply that no such payments are in fact wages. *Id.* at 1342 (emphasis added).

The Federal Circuit reasoned as follows:

> To say that all payments falling within a particular category shall be treated as if they were a payment of wages does not dictate, as a matter of language or logic, that none of the payments within

that category would otherwise be wages. For example, to say that for some purposes all men shall be treated as if they were six feet tall does not imply that no men are six feet tall. Moreover, section 3402(*o*) does not simply say that SUB payments shall be treated as wages; it provides that SUB payments shall be treated as if they were "a payment of wages by an employer to an employee for a payroll period." To say that certain payments do not constitute a payment of wages for a payroll period falls short of saying that the payments lack the legal character of "wages" altogether. In sum, the inference that CSX seeks to draw from the statutory language is simply too strained. Thus, while some supplemental unemployment benefit payments do not constitute "wages," it does not follow that all payments fitting within the broad definition of SUB in section 3402(*o*)(2)(A) are non-wages.[3] We therefore conclude that the text of section 3402(*o*) does not require that FICA be interpreted to exclude from "wages" all payments that would satisfy the definition of SUB in section 3402(*o*)(2)(A).

*CSX Corp.*, 518 F.3d at 1342 (footnote omitted).

With all due respect to the Federal Circuit, it is the above analogy to six-feet tall men that strains logic and effectively ignores clear statutory provisions. If the underlying presumption in § 3402(*o*) was that SUB payments were both wages and non-wages depending on the particular case, that distinction could easily have been made in the statute. The clear import of § 3402(*o*) is that any payment meeting the definition of

"supplemental unemployment compensation benefits" in § 3402(*o*)(2) is not considered to be "wages." Otherwise, the additional statement, "shall be treated *as if it were a payment of wages* by an employer to an employee for a payroll period" is not only unnecessary but also meaningless. That is, in the context of the above analogy, there is no need for an express statement that all men who *are* six-feet tall shall be treated *as if* they are six-feet tall. Similarly, if SUB pay already falls within the definition of "wages," there is no need to state that it shall be treated *as if it were* wages. If the SUB pay is already "wages," it is already subject to income tax withholding.

Accordingly, this Court agrees with the Bankruptcy Court that the Federal Circuit's decision in *CSX* does not undermine the reasoning or initial result reached by the Bankruptcy Court concerning the severance payments in this case.

## V. Conclusion

"Congress, by enacting FICA, intended to impose FICA taxes on a broad range of remuneration in order to accomplish the remedial purposes of the Social Security Act." *Appoloni*, 450 F.3d at 190 (citing H.R. Rep. No. 74-615, at 3 (1935) (describing the aims of the Social Security Act)). The limits on taxation, however, are not boundless, as Congress has made clear in numerous statutory exceptions to FICA and FUTA taxation. This case involves severance payments "made 'because of the employees' involuntary separation from employment,' which resulted 'directly from a reduction

in force or the discontinuance of a plant or operation.'" *Quality Stores*, 383 B.R. at 69 (citing Stip. Facts ¶ 15). The severance payments thus fall within the § 3402(*o*)(2) exception to wages for "supplemental unemployment compensation benefits." The severance payments are not taxable for purposes of FICA taxation, and the Bankruptcy Court did not err in so determining. The decision of the Bankruptcy Court is therefore affirmed.

An Order consistent with this Opinion will be entered.

## APPENDIX D

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF MICHIGAN

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Bankruptcy No. GG 01-10662
Adversary No. 05-80573

QUALITY STORES, INC., ET AL., PLAINTIFFS

*v.*

UNITED STATES OF AMERICA, DEFENDANT

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Filed: Mar. 3, 2008

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**OPINION REGARDING SEVERENCE PAY AND FICA CONTRIBUTIONS**

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JAMES D. GREGG, Chief Judge.

### I. *INTRODUCTION*

Employees of Quality Stores, Inc., et al. ("Debtors") received severance pay resulting from their involuntary termination from employment because of business cessation. The money received, without question, constitutes "income" within the meaning of the Internal Revenue Code. The question is whether the receipt of the severance pay by the employees constitutes "wages" as well. "Income" and "wages" are not coterminous. Under the facts of this case, where is

the legal boundary line between "income" and "wages" to be drawn?

## II. *ISSUE*

Are the Debtors entitled to a turnover from the United States of America, Internal Revenue Service ("IRS") of payments made for Federal Insurance Contributions Act ("FICA") taxes attributable to severance payments made to the Debtors' employees?[1]

## III. *JURISDICTION*

The court has subject matter jurisdiction over this bankruptcy case and this adversary proceeding. 28 U.S.C. § 1334. The case and all related proceedings have been referred to this court for decision. 28 U.S.C. § 157(a) and L.R. 83.2(a) (W.D. Mich.). This adversary proceeding is a core proceeding. 28 U.S.C. § 157(b)(2)(E) (turnover of property of the estate).

## IV. *FACTS*

The parties have stipulated to the relevant facts for purposes of this summary judgment motion ("Stip. Facts"). Prior to their bankruptcy cases, the Debtors operated a chain of retail stores specializing in agricultural supplies and related products. During the period preceding the bankruptcy cases (the "Prepetition Period"), the Debtors were forced to close approximately sixty-three stores and nine distribution cen-

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[1] This court freely acknowledges it is not an expert in tax law. At oral argument, both parties advised the court, regardless of its decision, this decision will be reviewed by the higher courts.

ters. The Debtors also terminated approximately seventy-five employees at their corporate office during the Prepetition Period.

On October 20, 2001, an involuntary chapter 11 petition was filed against the Debtors. Quality Stores, Inc., answered the involuntary petition and consented to the entry of an order for relief on November 1, 2001. The remaining Debtors also commenced voluntary chapter 11 cases on November 1, 2001. After the petition date (the "Postpetition Period"), the Debtors closed their remaining 311 stores and three distribution centers. The Debtors also terminated all of their remaining employees.

The Debtors made severance payments to employees who were terminated during both the Prepetition and Postpetition Periods. The parties agree that the severance payments were made "pursuant to [severance plans] maintained by the Debtors." (Stip. Facts ¶ 15.) The parties further stipulate that the severance payments were made "because of the employees' involuntary separation from employment," which resulted "directly from a reduction in force or the discontinuance of a plant or operation." (Stip. Facts ¶ 15.) The severance payments were included in the employees' gross income, and the Debtors reported the severance payments as wages on the W-2 forms issued to employees. The Debtors withheld federal income tax and the employees' share of FICA tax from the severance payments. The Debtors also paid the employer's share of FICA tax with respect to the severance payments.

Under the Prepetition Severance Plan, the Debtors' senior executives received twelve to eighteen months of severance pay. All other employees received one week of severance pay for each full year of service. These payments were not connected to the receipt of state unemployment compensation and were not attributable to the rendering of any particular employment service. The severance payments were paid on a weekly or semiweekly basis, in accordance with the Debtors' normal payroll period. Approximately $382,362 of the total refund requested in this adversary proceeding is attributable to severance payments made under the Prepetition Severance Plan.

Under the Postpetition Severance Plan, officers received six to twelve months of severance pay. Full-time salaried and hourly employees who had been employed for at least two years received one week of severance pay for each full year of service, up to a maximum of ten weeks for salaried employees and five weeks for hourly employees. Employees who had worked for the Debtors for less than two years received one week of severance pay, and the approximately 900 employees who were subsequently employed by the companies who purchased the Debtors' assets did not receive any severance pay. Like the prepetition severance payments, the postpetition payments were not connected to the receipt of state unemployment compensation and were not attributable to the rendering of any particular employment services. All severance payments for the Postpetition Period were paid in a lump sum. Approximately $617,763 of

the total refund requested in this adversary proceeding is attributable to payments made under the Postpetition Severance Plan.

On September 17, 2002, the Debtors filed fifteen separate refund claims with the IRS, seeking to recover $1,000,125 in allegedly overpaid FICA taxes.[2] On June 1, 2005, the Debtors filed this adversary proceeding. The Debtors' complaint seeks to compel the IRS to turn over the alleged overpaid FICA taxes, plus interest, as property of the Debtors' bankruptcy estate. Because the issue presented in this adversary proceeding is a purely legal question, the parties filed stipulated facts and cross motions for summary judgment. Legal memoranda were filed, oral argument was held, and the court took the matter under advisement.

## V. *DISCUSSION*

### A. *Summary Judgment Standard*

Motions for summary judgment are governed by Federal Rule of Civil Procedure 56(c). FED. R. BANKR. P. 7056. Under Rule 56(c), summary judgment is appropriate "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the

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[2] This amount includes the employer's share of FICA taxes paid by the Debtors and the employees' share of FICA taxes for those employees who consented to permit the Debtors to make the refund request on their behalf.

moving party is entitled to a judgment as a matter of law." FED. R. CIV. P. 56(c). All material facts have been stipulated to by the parties to this adversary proceeding. The parties agree, and this court believes, that the legal issues presented are appropriate for resolution by summary judgment.

B. *Did the Severance Payments to the Debtors' Employees Constitute "Wages"?*

FICA taxes are imposed on employees' "wages" "to fund Social Security and Medicare Benefits." *Appoloni v. United States*, 450 F.3d 185, 189 (6th Cir. 2006), *cert. denied*, — U.S. —, 127 S. Ct. 1123, 166 L. Ed. 2d 891 (2007). For purposes of FICA, § 3121(a) of the Internal Revenue Code defines "wages" as "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash." 26 U.S.C. § 3121(a).[3] The

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[3] Section 3121 provides, in pertinent part:

(a) Wages.—For purposes of this chapter, the term "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include—

. . .

(2) the amount of any payment (including any amount paid by an employer for insurance or annuities, or into a fund, to provide for any such payment) made to, or on behalf of, an employee or any of his dependents under a plan or system established by an employer which makes provision for his employees generally (or for his employees generally and their dependents) or for a class or classes of his employees (or for a

broad, inclusive nature of this definition has been recognized by both the United States Supreme Court and the Sixth Circuit Court of Appeals. *See Social Sec. Bd. v. Nierotko*, 327 U.S. 358, 365-66, 66 S. Ct. 637, 641, 90 L. Ed. 718 (1946); *Gerbec v. United States*, 164 F.3d 1015, 1026 (6th Cir. 1999). A broad interpretation of this definition has also been deemed consistent with

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class or classes of his employees and their dependents), on account of—

(A) sickness or accident disability (but, in the case of payments made to an employee or any of his dependents, this subparagraph shall exclude from the term wages only payments which are received under a workmen's compensation law), or

(B) medical or hospitalization expenses in connection with sickness or accident disability, or . . .

(4) any payment on account of sickness or accident disability, or medical or hospitalization expenses in connection with sickness or accident disability, made by an employer to, or on behalf of, an employee after the expiration of 6 calendar months following the last calendar month in which the employee worked for such employer,

(5) any payment made to, or on behalf of, an employee or his beneficiary—

. . .

(B) under or to an annuity plan which, at the time of such payment, is a plan described in section 403(a),

. . .

(D) under or to an annuity contract described in section 403(b), other than a payment for the purchase of such contract which is made by reason of a salary reduction agreement (whether evidenced by a written instrument or otherwise). . . .

26 U.S.C. § 3121(a).

Congress's intent "to impose FICA taxes on a broad range of remuneration in order to accomplish the remedial purposes of the Social Security Act." *Appoloni*, 450 F.3d at 190 (citation omitted).

An employee's "wages" are also the basis for measuring an employer's obligations under the income tax withholding provisions of the Internal Revenue Code. *Rowan Cos. v. United States*, 452 U.S. 247, 254, 101 S. Ct. 2288, 2293, 68 L. Ed. 2d 814 (1981). For income tax withholding purposes, Congress choose to define the term "wages" in "substantially the same language that it used in FICA. . . . " *Rowan*, 452 U.S. at 255, 101 S. Ct. at 2293. Accordingly, the income tax withholding provisions of the Internal Revenue Code define "wages" as "all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash." 26 U.S.C. § 3401(a).

In the income tax context, § 3402(*o*) extends the withholding requirement to "certain payments *other than* wages" including (1) "any supplemental unemployment compensation benefit paid to an individual;" (2) certain annuity payments to an individual; and (3) certain payments of sick pay to an individual. 26 U.S.C. § 3402(*o*) (emphasis added). Section 3402(*o*)(1) states that each of these types of payments shall be "treated *as if it were a payment of wages*" for income tax withholding purposes.[4] 26 U.S.C.

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[4] Section 3402(*o*)(1) provides:

§ 3402(*o*)(1) (emphasis added). The Internal Revenue Code defines "supplemental unemployment compensation benefits" as:

> amounts which are paid to an employee, pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment (whether or not such separation is temporary), resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, but only to the extent such benefits are includible in the employees gross income.

26 U.S.C. § 3402(*o*)(2)(A). In this adversary proceeding, the Debtors and the IRS have stipulated that the severance payments made under both the Pre- and Post-petition Severance Plans meet this definition. (Stip. Facts ¶ 15.)

The Debtors assert that supplemental unemployment compensation benefits are not wages for income

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> (1) General rule.—For purposes of this chapter . . . —
>
> (A) any supplemental unemployment compensation benefit paid to an individual,
>
> (B) any payment of an annuity to an individual, if at the time the payment is made a request that such annuity be subject to withholding under this chapter is in effect, and
>
> (C) any payment to an individual of sick pay which does not constitute wages . . . , if at the time the payment is made a request that sick pay be subject to withholding under this chapter is in effect,
>
> shall be treated as if it were a payment of wages by an employer to an employee for a payroll period. 26 U.S.C. § 3402(*o*)(1).

tax withholding purposes, but in accordance with § 3402(*o*), are merely treated *as if they were wages.* As additional support for this proposition, the Debtors examine the legislative history of § 3402(*o*). The Senate report explained that supplemental unemployment compensation benefits were not subject to withholding under prior law "because they [did] not constitute wages or remuneration for services." S. Rep. No. 91-552, at 268 (1969), *reprinted in* 1969 U.S.C.C.A.N. 2027, 2305-06. Section 3402(*o*) makes these payments subject to withholding because "although these benefits are not wages" they are "generally taxable income to the recipient" and "the absence of withholding on these benefits may require a significant final tax payment by the taxpayer receiving them." *Id.*

The Debtors argue that if supplemental unemployment compensation benefits are not wages for purposes of income tax withholding, they are likewise not wages for purposes of FICA taxation. This assertion is anchored upon the United States Supreme Court's decision in *Rowan Cos. v. United States*, 452 U.S. 247, 101 S. Ct. 2288, 68 L. Ed. 2d 814 (1981). In *Rowan*, the Supreme Court considered whether the definition of "wages" under FICA and the Federal Unemployment Tax Act ("FUTA") included the value of meals and lodging provided to employees working on Rowan Companies' offshore oil rigs. Pursuant to the Treasury Regulations in effect at the time, the IRS included the fair value of these meals and lodging in withholding "wages" for purposes of FICA and FUTA, but not

for income tax withholding purposes. The Treasury Regulations prescribed this practice notwithstanding the fact that Congress defined the term "wages" in "substantially identical language for each of these three obligations upon employers." *Rowan*, 452 U.S. at 249, 101 S. Ct. at 2290.

Based on the nearly identical definitions of "wages" in the three statutes, the Supreme Court concluded that "Congress intended 'wages' to mean the same thing under FICA, FUTA, and income-tax withholding." *Rowan*, 452 U.S. at 254, 101 S. Ct. at 2293. According to the Court, the statutory scheme was born out of "congressional concern for 'the interest of simplicity and ease of administration.'" *Rowan*, 452 U.S. at 254, 101 S. Ct. at 2293-94 (citation omitted). The Court found that "[i]t would be extraordinary for a Congress pursuing this interest to intend, without ever saying so, for identical definitions to be interpreted differently." *Rowan*, 452 U.S. at 257, 101 S. Ct. at 2294. Therefore, the Court held that the Treasury Regulations were invalid, because they "fail[ed] to implement the statutory definition of 'wages' in a consistent or reasonable manner." *Rowan*, 452 U.S. at 263, 101 S. Ct. at 2298.

The arguments proffered by the Debtors in this adversary proceeding were thoroughly analyzed and accepted by the United States Court of Federal Claims in a recent opinion, *CSX Corp. v. United States*, 52 Fed. Cl. 208 (Fed. Cl. 2002). *CSX* involved an almost identical issue to the one presented in this adversary proceeding, i.e., whether payments made by the em-

ployer under a reduction in force program constituted "wages" for purposes of FICA taxation.[5] Relying on the similarities in the definitions of "wages" for purposes of FICA and income tax withholding, the treatment of "supplemental unemployment compensation benefits" as non-wages in § 3402(*o*), and the Supreme Court holding in *Rowan*, the *CSX* court concluded that FICA taxes did not apply to the payments. The court explained:

> [P]ayments that are nonwage payments from the start are beyond FICA taxation as much as they are beyond income-tax withholding.
>
> ---
>
> Since supplemental unemployment compensation benefits "do not constitute wages or remuneration for services" . . . their taxation under FICA would require their specific inclusion in § 3121(a). And because there is no specific inclusion of supplemental unemployment compensation benefits in § 3121(a), no FICA taxes apply to such payments.

*CSX Corp.*, 52 Fed. Cl. at 215-16 (internal citation omitted).

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[5] *CSX* also addressed whether the reduction in force payments were "compensation" under the Railroad Retirement Tax Act ("RRTA"). *See* 26 U.S.C. §§ 3201-3202 and 3231-3233. The RRTA's definition of "compensation" is essentially identical to FICA's definition of "wages." *Compare* 26 U.S.C. § 3121(a) *with* 26 U.S.C. § 3231(e).

In reaching this conclusion, the *CSX* court rejected many of the same arguments raised by the IRS in this adversary proceeding. This court will address each of the IRS's arguments in turn.

1. *Decoupling Amendment*

First, the IRS argues that Congress explicitly rejected the holding in *Rowan* when it enacted the Social Security Amendments of 1983, Pub. L. No. 98-21, 97 Stat. 65 (1983). According to the IRS, these amendments contain a "decoupling" provision that specifically rejects *Rowan's* conclusion that wages should be defined the same for purposes of income tax withholding and FICA taxation. The "decoupling" amendment states:

> Nothing in the regulations prescribed for purposes of chapter 24 (relating to income tax withholding) which provides an exclusion from "wages" as used in such chapter shall be construed to require a similar exclusion from "wages" in the regulations prescribed for purposes of this chapter.

26 U.S.C. § 3121(a). The IRS argues that the legislative history of the "decoupling" amendment further illustrates Congress's rejection of the holding in *Rowan*. For instance, the Senate Report explains:

> [T]he committee believes that amounts exempt from income tax withholding should not be exempt from FICA unless Congress provides an explicit FICA tax exclusion.
>
> . . . .

> The bill provides that . . . the determination of whether or not amounts are includible in the social security wage base is to be made without regard to whether such amounts are treated as wages for income tax withholding purposes. Accordingly, an employee's "wages" for social security tax purposes may be different from the employee's "wages" for income tax withholding purposes.

S. Rep. No. 98-23, at 42 (1983), *reprinted in* 1983 U.S.C.C.A.N. 143, 183.[6]

As noted by the *CSX* court, the IRS's argument on this point has some superficial appeal. The court explained that by enacting the "decoupling" amendment "Congress has indeed gone on record as saying

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[6] The IRS asserts that the *CSX* court erred by not according more weight to the Congress's intent as expressed in this legislative history to the "decoupling" amendment. However, it is well-settled that "[w]hen interpreting a statute, courts must first consider the plain language of the statute, and resort to a review of congressional intent or legislative history only when the language of the statute is not clear." *QSI Holdings, Inc. v. Alford*, 382 B.R. 731, 737, 2007 WL 4557855 *3 (W.D. Mich. 2007) (citing *In re Comshare, Inc. Sec. Litigation*, 183 F.3d 542, 549 (6th Cir. 1999)); *see United States v. Ron Pair Enter., Inc.*, 489 U.S. 235, 241, 109 S. Ct. 1026, 1030, 103 L. Ed. 2d 290 (1989) (when a "statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.'") (citation omitted). Here, the statutes are not ambiguous. Therefore, the *CSX* court properly declined to "draw upon the legislative history of the decoupling provision' to establish a distinction between wages for FICA purposes and wages for income-tax purposes despite the absence of any law, expressed either in statute or regulation, creating such a distinction." *CSX Corp.*, 52 Fed. Cl. at 214 n.7.

that the income-tax withholding system and the FICA-tax withholding system each serves a different interest which may, in turn, dictate differences in the make-up of their respective wage bases." *CSX Corp.*, 52 Fed. Cl. at 213. However, the *CSX* court ultimately rejected the IRS's argument, finding that the "decoupling" amendment enacted by Congress to facilitate differentiation between income tax withholding and FICA taxation "is not self-executing." *Id.* Rather, "its operation depends on the promulgation of regulations that in fact establish distinctions between wages for income-tax withholding purposes and wages for FICA-tax withholding purposes." *Id.* Without such regulations, there is "no basis for distinguishing between the content of the term 'wages' for income-tax withholding purposes and the content of that term for FICA-tax withholding purposes. Simply put, the holding of *Rowan* remains in place." *Id.*; *see also HB & R, Inc. v. United States*, 229 F.3d 688, 692 (8th Cir. 2000) (noting that "Congress 'decoupled' the definition of wages for income and FICA tax purposes to allow the Commissioner to promulgate regulations providing different withholding exclusions. . . . "); *Anderson v. United States*, 929 F.2d 648, 653 n.10 (Fed. Cir. 1991) (opining, in dicta, that the "decoupling" amendment provides "for treating 'wages' in both statutes differently, but only through exclusions promulgated by regulation").

This court agrees with the *CSX* opinion. The "decoupling" amendment overrules *Rowan* to the extent that it gives the IRS the ability to define "wages" dif-

ferently for income and FICA tax purposes through valid regulations. However, *Rowan's* more narrow holding—that, as a threshold matter, the term "wages" should be interpreted the same for FICA and income tax withholding purposes—remains binding. This court therefore rejects the IRS's argument that the "decoupling" amendment supersedes the Supreme Court's decision in *Rowan*.

2. *The Revenue Rulings*

The IRS is unable to point to any regulation that would require the severance payments to be treated differently for FICA purposes than they are for income tax withholding purposes. The IRS argues, however, that it has established a limited exception to FICA's definition of "wages" for certain payments made upon an employee's separation from the employer's service. The IRS maintains that this limited exception was promulgated through a series of revenue rulings, "culminating in Rev. Rul. 90-72, 1990-2 C.B. 211." (Dft. Brief at 9.) According to the IRS, this exception only applies if: (1) the employee was involuntarily separated from service due to a plant closing, layoff, or reduction in force; (2) the employee also received state unemployment compensation; (3) the supplemental unemployment compensation payment was not received as a lump sum. The parties have stipulated that the payments at issue in this adversary proceeding do not meet these criteria. (Stip. Facts ¶ 21, 27 & 28.)

Revenue rulings do not have the binding force of statutory provisions or the presumption of correctness of the regulations. *See Appoloni v. United States*, 450 F.3d 185, 194 (6th Cir. 2006), cert. denied, — U.S. —, 127 S. Ct. 1123, 166 L. Ed. 2d 891 (2007) (citing *Skidmore v. Swift & Co.*, 323 U.S. 134, 140, 65 S. Ct. 161, 164, 89 L. Ed. 124 (1944)); *Aeroquip-Vickers, Inc. v. Comm'r*, 347 F.3d 173, 181 (6th Cir. 2003) (noting that "the IRS does not invoke its authority to make rules with the force of law" when it issues revenue rulings). However, some varying degree of deference to revenue rulings is required. [T]he level of deference to be accorded to [revenue rulings] depends upon "the thoroughness evident in [the ruling's] consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade. . . ." *Aeroquip-Vickers, Inc.*, 347 F.3d at 181; *see Appoloni*, 450 F.3d at 194. Applying this standard to Rev. Rul. 90-72, the court opines that the ruling is not entitled to persuasive deference.

First, the IRS's treatment of "supplemental unemployment compensation benefits" has not been very consistent over time. *See, e.g.*, Rev. Rul. 56-249, 1956-1 C.B. 488, 492 (first establishing a limited exception from the FICA, FUTA, and income tax withholding definition of "wages" for certain payments made to an employee upon his or her involuntary separation from employment; the ruling set forth eight criteria that must be met for payments to qualify for this exception); Rev. Rul. 58-128, 1958-1 C.B. 89 (broadening

and clarifying the scope of Rev. Rul. 56-249); Rev. Rul. 60-330, 1960-2 C.B. 46, Rev. Rul. 71-408, 1971-2 C.B. 340; Rev. Rul. 77-347, 1977-2 C.B. 362 (reversing course, and stating that benefits did not be tied to the receipt of state unemployment benefits to be considered supplemental unemployment compensation benefits for purposes of FICA, FUTA and income tax withholding); Rev. Rul. 90-72, 1990-2 C.B. at 212 (stating that "[t]he portion of Rev. Rul. 77-347 concluding that benefits do not have to be linked to state unemployment compensation in order to be excluded from the definition of wages for FICA and FUTA tax purposes is inconsistent with the underlying premises for the exclusion and is therefore hereby revoked").

More importantly, the revenue ruling relied upon by the IRS, 90-72, offers no cogent explanation for its overly broad conclusion that "the definition of [supplemental unemployment compensation benefits] under section 3402(*o*) is not applicable for FICA or FUTA purposes." 1990-2 C.B. at 211-12. In the absence of such analysis, this court is unable to ignore or downplay the plain language of §§ 3121(a) and 3402(*o*) and *Rowan's* admonition that the income tax and FICA provisions are to be interpreted and applied consistently.

3. *Statutory Exclusions from FICA Definition of "Wages"*

The IRS's third argument arises from differences in the statutory exclusions under the income tax withholding scheme, § 3402(*o*), and the FICA provisions,

§ 3121(a). The IRS notes that only two of the three types of payments "treated as wages" for income tax purposes—i.e., annuity payments and sick pay, but not supplemental unemployment compensation benefits—are also specifically excluded from FICA wages under § 3121(a). According to the IRS, it was unnecessary for Congress to exclude annuity payments and sick pay from FICA's definition of "wages" if all three of the items referred to in § 3402(*o*), including supplemental unemployment compensation benefits, were already considered non-wage payments for purposes of FICA.

As the *CSX* court discussed in its detailed analysis of this argument, the reason for these exclusions is explained by the disparate nature of the types of payments. For instance, annuity payments are considered "remuneration for services" and are thus deemed "wages" for purposes of both FICA and income tax withholding. Nonetheless, these payments are specifically excluded from the definition of "wages" under the two statutes. By enacting § 3402(*o*), Congress gave employees the option of requesting that such payments be subject to income tax withholding (i.e., to have the payments "treated as if they were wages"), to help the employee cushion an unexpectedly large tax bill at the year end. Supplemental unemployment compensation benefits, on the other hand, are not considered to be "remuneration for services." Accordingly, these types of payments do not initially fall under the statutory definitions of "wages," and there is no good reason to specifically exclude them from FICA taxation.

Again, the rationale of the *CSX* court is persuasive: "the absence of an exclusion from the definition of wages for FICA purposes is not determinative of whether a particular payment is subject to FICA taxation." *CSX Corp.*, 52 Fed. Cl. at 216. Instead, "[t]he question that needs to be asked is whether the payment falls outside the definition of wages from the start." *Id.* The taxation of non-wage payments "requires their specific inclusion in the taxing scheme." *id.* at 215 (emphasis in original).

4. *Sixth Circuit Precedent—Appoloni v. United States*

Finally, the IRS asserts that this court should not adopt the "extremely narrow and strained interpretation" of "wages" for purposes of FICA taxation employed by the court in *CSX* because such interpretation is "thoroughly inconsistent" with Sixth Circuit case law which instructs that FICA is to be broadly construed. (Dft. Br. at 15.) The IRS refers to *Appoloni v. United States*, 450 F.3d 185 (6th Cir. 2006), *cert. denied*, — U.S. —, 127 S. Ct. 1123, 166 L. Ed. 2d 891 (2007). The issue in *Appoloni* was whether payments made to public school teachers, who resigned from their positions and relinquished their tenure rights upon receipt of such payments, were taxable "wages" under FICA. *Id.* at 189. Based largely on the eligibility requirements for receipt of the payments, the court held that the payments were remuneration "for services performed" and consequently, were "wages" for purposes of FICA taxation. *Id.* at 191. The court reached this conclusion despite the fact that the

teachers also relinquished tenure rights by accepting the payments. *id.* at 192-95 (rejecting *North Dakota State Univ. v. United States*, 255 F.3d 599 (8th Cir. 2001)). The Sixth Circuit's analysis of the issue also emphasized the "broad, inclusive nature" of FICA's definition of "wages." *Id.* at 190 (citing *Social Security Bd. v. Nierotko*, 327 U.S. 358, 365-66, 66 S. Ct. 637, 641, 90 L. Ed. 718 (1946); *Gerbec v. United States*, 164 F.3d 1015, 1026 (6th Cir. 1999)). The IRS concedes that *Appoloni* is not directly on point, but argues that the decision illustrates the Sixth Circuit's general approach to interpreting the definition of "wages" for purposes of FICA taxation.

This court agrees that *Appoloni* is not directly relevant to the issue presented in this adversary proceeding. Importantly, in contrast to the payments at issue in this adversary proceeding, the payments in *Appoloni* did not qualify as "supplemental unemployment compensation benefits" under § 3402(*o*). Therefore, the facts in *Appoloni* did not require the Sixth Circuit to determine whether "supplemental unemployment compensation benefits" should be deemed "wages" under FICA. Instead, the *Appoloni* court applied the general definition of "wages" to the payments at issue in that case.

However, notwithstanding the different issues discussed, this court believes that *CSX* and *Appoloni* are consistent. After concluding that "supplemental unemployment compensation benefits" were not wages under FICA, the second portion of the *CSX* opinion addressed whether the specific payments at issue in

that case actually qualified as "supplemental employment compensations benefits" under § 3402(*o*). In making this determination, the *CSX* court stated it was "mindful" that FICA was subject to broad interpretation and cited the same precedent relied upon in *Appoloni* for this proposition. *CSX Corp.*, 52 Fed. Cl. at 218 (citing *Nierotko*, 327 U.S. at 366, 66 S. Ct. at 641). The *CSX* court went on to conclude that separation payments to "employees who elect[ed] separation in lieu of remaining in their existing positions" did "not qualify as supplemental unemployment compensation benefits" because those employees were not "involuntarily separated" from their employment. *CSX Corp.*, 52 Fed. Cl. at 220. The *CSX* court held that these separation payments were "wages" despite the fact that the employees relinquished certain rights to receive them. *Id.* at 221 (When "job-related benefits [tike vacation pay, sick pay, layoff pay, seniority or tenure rights] are relinquished in favor of a lump-sum payment, the transaction simply amounts to a redemption, paid in cash, of wage amounts previously paid in kind.") (also rejecting *North Dakota*, 255 F.3d 599). Interestingly, *Appoloni* cited this portion of the *CSX* opinion in its discussion of the effect of relinquishment of tenure rights and expressly agreed with the reasoning employed therein. *Appoloni*, 450 F.3d at 195.

5. *Summary*

Simply stated, this court agrees with the *CSX* opinion. Considering the nearly identical statutory definitions, and under the Supreme Court's decision in *Rowan*, the term "wages" should be interpreted the

same for both FICA and income tax purposes. Because "supplemental unemployment compensation benefits" are not "wages" for purposes of income tax withholding, they are likewise not "wages" under FICA. Although the "decoupling" provision gives the IRS the ability to establish distinctions between the two statutory definitions, such distinctions must be made through the promulgation of valid regulations. No such regulations exist. Accordingly, this court concludes that the payments made to the Debtors' employees pursuant to the Pre- and Postpetition Severance programs are not "wages" for purposes of FICA taxation. The IRS shall refund the overpaid FICA taxes to the Debtors' bankruptcy estate.

## VI. *CONCLUSION*

For the reasons stated above, the Debtors' motion for summary judgment is GRANTED and the IRS's cross motion for summary judgment is DENIED. A further hearing shall be scheduled as soon as is practicable to determine the amount of the refund to be turned over, including a calculation of the interest to be paid. A separate order shall enter accordingly.

**APPENDIX E**

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF MICHIGAN

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Case No. GG 01-10662 (Jointly Administered) Chapter 11
Adversary Proceeding No. 05-80573

IN RE: QUALITY STORES, INC., ET AL., DEBTORS

QUALITY STORES, INC., ET AL., PLAINTIFFS

*v.*

UNITED STATES OF AMERICA, DEFENDANT

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[Filed: Aug. 29, 2008]

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**ORDER GRANTING DEFENDANT'S MOTION FOR RECONSIDERATION AND ORDER RATIFYING PRIOR OPINION AND ORDER**

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*At a session of said court of bankruptcy, held in and for said district, on August 29, 2008.*

PRESENT: HONORABLE JAMES D. GREGG
Chief United States Bankruptcy Judge

On May 16, 2008, the United States of America, Internal Revenue Service ("IRS") filed a Motion to Recon-

sider in the above-captioned adversary. The motion requests that the court reconsider its prior Opinion and Order Regarding Severance Pay and FICA Contributions, dated February 21, 2008. The principal basis for the motion to reconsider is that one case relied upon by this court, *CSX Corp. v. United States*, 52 Fed. Cl. 208 (Fed. Cl. 2002), was partially reversed by the United States Court of Appeals for the Federal Circuit shortly after this court issued its decision. *See CSX Corp. v. United States*, 518 F.3d 1328 (Fed. Cir. 2008). This court has reviewed the Court of Appeals' opinion and, after careful consideration, has determined not to change its prior decision.

NOW, THEREFORE, IT IS HEREBY ORDERED that:

1. The Motion to Reconsider filed by the IRS be, and hereby is, GRANTED.

2. Upon reconsideration, this court's prior Opinion and Order Regarding Severance Pay and FICA Contributions, dated February 21, 2008, be, and hereby are, ratified. The prior order remains valid and binding.

3. A hearing to determine the specific amount of the refund, including interest, to be turned over to Quality Stores, Inc., et al. by the IRS shall be held on **October 16, 2008, at 1:00 p.m.** in **Grand Rapids**, Michigan.

4. This is NOT a final order.

IT IS FURTHER ORDERED that a copy of this order shall be served by electronic means (ECF) or first-class United States mail, postage pre-paid, upon the following persons:

Janet S. Baer, Esq. (ECF)

Natalie Hoyer Keller, Esq.
Kirkland & Ellis LLP
200 East Randolph Dr
Suite 5500 Chicago, IL 60601

Michael W. Davis, Esq. (ECF)

Michael L. Shiparski, Esq. (ECF)

/s/ JAMES D. GREGG
HONORABLE JAMES D. GREGG
Chief United States Bankruptcy Judge

[SERVED AS ORDERED: S. Combs Aug. 29]

## APPENDIX F

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF MICHIGAN

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Bankruptcy No. GG 01-10662
Adversary No. 05-80573

QUALITY STORES[1], INC., ET AL., DEBTOR

QUALITY STORES, INC., ET AL., PLAINTIFFS

*v.*

UNITED STATES OF AMERICA, DEFENDANT

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[Filed: Nov. 25, 2008]

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**FINAL JUDGMENT**

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Based upon the parties' stipulation and the other materials of record, it is hereby adjudged that Plaintiff, Quality Stores, Inc. et al., shall recover from Defendant,

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[1] The Debtors are the following entities: QSI Holdings, Inc. (f/k/a CT Holdings, Inc.); Quality Stores, Inc. (f/k/a Central Tractor Farm & Country, Inc.); Country General, Inc.; F and C Holding. Inc.; FarmandCountry.com, LLC; QSI Newco, Inc.; QSI Transportation, Inc.; Quality Farm & Fleet, Inc.; Quality Investments, Inc.; Quality Stores Services, Inc.; and Vision Transportation, Inc.

United States of America, the sum of One Million One Hundred and Twenty-Five Dollars ($1,000,125.00), plus interest as provided by law.

The adjudged amount represents a refund of taxes paid per the Federal Insurance Contributions Act ("FICA") for periods ending in the years 1999 through 2002, as requested in Plaintiff's claims for refund, filed on September 17, 2002. The sum of Five Hundred Seventy-One thousand Four Hundred and Five dollars ($571,405.00), plus interest as provided by law, represents the employer portion of the refund, and the sum of Four Hundred Twenty-Eight Thousand Seven Hundred and Twenty Dollars ($428,720.00), plus interest as provided by law, represents the employee portion of the refund. The components of the adjudged amount are further itemized in the exhibits attached to the Complaint, which are incorporated herein by reference.

This is a final judgment for purposes of appeal.

Date: Nov. 25, 2008

/s/ JAMES D. GREGG
HONORABLE JAMES D. GREGG
Chief United States Bankruptcy Judge

Approved as to form:

Date: Nov. 18, 2008

/s/ L. STEVEN SCHIFANO
L. STEVEN SCHIFANO, Trial Attorney
United States Department of Justice

Tax Division, Civil Trial Section,
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Date: Nov. 19, 2008

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*Judgment drafted by Attorney Schifano*

## APPENDIX G

1. 26 U.S.C. 3101 provides:

**Rate of tax**

**(a) Old-age, survivors, and disability insurance**

In addition to other taxes, there is hereby imposed on the income of every individual a tax equal to the following percentages of the wages (as defined in section 3121(a)) received by him with respect to employment (as defined in section 3121(b))—

| **In cases of wages received during:** | **The rate shall be:** |
|---|---|
| 1984, 1985, 1986, or 1987 | 5.7 percent |
| 1988 or 1989 | 6.06 percent |
| 1990 or thereafter | 6.2 percent. |

**(b) Hospital insurance**

In addition to the tax imposed by the preceding subsection, there is hereby imposed on the income of every individual a tax equal to the following percentages of the wages (as defined in section 3121(a)) received by him with respect to employment (as defined in section 3121(b))—

(1) with respect to wages received during the calendar years 1974 through 1977, the rate shall be 0.90 percent;

(2) with respect to wages received during the calendar year 1978, the rate shall be 1.00 percent;

(3) with respect to wages received during the calendar years 1979 and 1980, the rate shall be 1.05 percent;

(4) with respect to wages received during the calendar years 1981 through 1984, the rate shall be 1.30 percent;

(5) with respect to wages received during the calendar year 1985, the rate shall be 1.35 percent; and

(6) with respect to wages received after December 31, 1985, the rate shall be 1.45 percent.

**(c) Relief from taxes in cases covered by certain international agreements**

During any period in which there is in effect an agreement entered into pursuant to section 233 of the Social Security Act with any foreign country, wages received by or paid to an individual shall be exempt from the taxes imposed by this section to the extent that such wages are subject under such agreement exclusively to the laws applicable to the social security system of such foreign country.

2. 26 U.S.C. 3121 (2006 & Supp. V 2011) provides:

**Definitions**

**(a) Wages**

For purposes of this chapter, the term "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include—

(1) in the case of the taxes imposed by sections 3101(a) and 3111(a) that part of the remuneration which, after remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) equal to the contribution and benefit base (as determined under section 230 of the Social Security Act) with respect to employment has been paid to an individual by an employer during the calendar year with respect to which such contribution and benefit base is effective, is paid to such individual by such employer during such calendar year. If an employer (hereinafter referred to as successor employer) during any calendar year acquires substantially all the property used in a trade or business of another employer (hereinafter referred to as a predecessor), or used in a separate unit of a trade or business of a predecessor, and immediately after the acquisition employs in his trade or business an individual who immediately prior to the acquisition was employed in the trade or business of such predecessor, then, for the purpose of determining whether the successor employer has paid remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) with respect to employment equal to the contribution and benefit base (as determined under section 230 of the Social Security Act) to such individual during such calendar year, any remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) with respect to employment paid (or considered under this paragraph as having been paid) to such individual by such predecessor during such

calendar year and prior to such acquisition shall be considered as having been paid by such successor employer;

(2) the amount of any payment (including any amount paid by an employer for insurance or annuities, or into a fund, to provide for any such payment) made to, or on behalf of, an employee or any of his dependents under a plan or system established by an employer which makes provision for his employees generally (or for his employees generally and their dependents) or for a class or classes of his employees (or for a class or classes of his employees and their dependents), on account of—

(A) sickness or accident disability (but, in the case of payments made to an employee or any of his dependents, this subparagraph shall exclude from the term "wages" only payments which are received under a workman's compensation law), or

(B) medical or hospitalization expenses in connection with sickness or accident disability, or

(C) death, except that this paragraph does not apply to a payment for group-term life insurance to the extent that such payment is includible in the gross income of the employee;

[(3) Repealed. Pub. L. 98-21, title III, § 324(a)(3)(B), Apr. 20, 1983, 97 Stat. 123]

(4) any payment on account of sickness or accident disability, or medical or hospitalization expenses in connection with sickness or accident disability, made

by an employer to, or on behalf of, an employee after the expiration of 6 calendar months following the last calendar month in which the employee worked for such employer;

(5) any payment made to, or on behalf of, an employee or his beneficiary—

(A) from or to a trust described in section 401(a) which is exempt from tax under section 501(a) at the time of such payment unless such payment is made to an employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust,

(B) under or to an annuity plan which, at the time of such payment, is a plan described in section 403(a),

(C) under a simplified employee pension (as defined in section 408(k)(1)), other than any contributions described in section 408(k)(6),

(D) under or to an annuity contract described in section 403(b), other than a payment for the purchase of such contract which is made by reason of a salary reduction agreement (whether evidenced by a written instrument or otherwise),

(E) under or to an exempt governmental deferred compensation plan (as defined in subsection (v)(3)),

(F) to supplement pension benefits under a plan or trust described in any of the foregoing provisions of this paragraph to take into account some

portion or all of the increase in the cost of living (as determined by the Secretary of Labor) since retirement but only if such supplemental payments are under a plan which is treated as a welfare plan under section 3(2)(B)(ii) of the Employee Retirement Income Security Act of 1974,

(G) under a cafeteria plan (within the meaning of section 125) if such payment would not be treated as wages without regard to such plan and it is reasonable to believe that (if section 125 applied for purposes of this section) section 125 would not treat any wages as constructively received,

(H) under an arrangement to which section 408(p) applies, other than any elective contributions under paragraph (2)(A)(i) thereof, or

(I) under a plan described in section 457(e)(11)(A)(ii) and maintained by an eligible employer (as defined in section 457(e)(1));

(6) the payment by an employer (without deduction from the remuneration of the employee)—

(A) of the tax imposed upon an employee under section 3101, or

(B) of any payment required from an employee under a State unemployment compensation law,

with respect to remuneration paid to an employee for domestic service in a private home of the employer or for agricultural labor;

(7)(A) remuneration paid in any medium other than cash to an employee for service not in the course of the employer's trade or business or for domestic service in a private home of the employer;

(B) cash remuneration paid by an employer in any calendar year to an employee for domestic service in a private home of the employer (including domestic service on a farm operated for profit), if the cash remuneration paid in such year by the employer to the employee for such service is less than the applicable dollar threshold (as defined in subsection (x)) for such year;

(C) cash remuneration paid by an employer in any calendar year to an employee for service not in the course of the employer's trade or business, if the cash remuneration paid in such year by the employer to the employee for such service is less than $100. As used in this subparagraph, the term "service not in the course of the employer's trade or business" does not include domestic service in a private home of the employer and does not include service described in subsection (g)(5);

(8)(A) remuneration paid in any medium other than cash for agricultural labor;

(B) cash remuneration paid by an employer in any calendar year to an employee for agricultural labor unless—

(i) the cash remuneration paid in such year by the employer to the employee for such labor is $150 or more, or

(ii) the employer's expenditures for agricultural labor in such year equal or exceed $2,500,

except that clause (ii) shall not apply in determining whether remuneration paid to an employee constitutes "wages" under this section if such employee (I) is employed as a hand harvest laborer and is paid on a piece rate basis in an operation which has been, and is customarily and generally recognized as having been, paid on a piece rate basis in the region of employment, (II) commutes daily from his permanent residence to the farm on which he is so employed, and (III) has been employed in agriculture less than 13 weeks during the preceding calendar year;

[(9) Repealed. Pub. L. 98–21, title III, § 324(a)(3)(B), Apr. 20, 1983, 97 Stat. 123]

(10) remuneration paid by an employer in any calendar year to an employee for service described in subsection (d)(3)(C) (relating to home workers), if the cash remuneration paid in such year by the employer to the employee for such service is less than $100;

(11) remuneration paid to or on behalf of an employee if (and to the extent that) at the time of the payment of such remuneration it is reasonable to believe that a corresponding deduction is allowable under section 217 (determined without regard to section 274(n));

(12)(A) tips paid in any medium other than cash;

(B) cash tips received by an employee in any calendar month in the course of his employment by an employer unless the amount of such cash tips is $20 or more;

(13) any payment or series of payments by an employer to an employee or any of his dependents which is paid—

(A) upon or after the termination of an employee's employment relationship because of (i) death, or (ii) retirement for disability, and

(B) under a plan established by the employer which makes provision for his employees generally or a class or classes of his employees (or for such employees or class or classes of employees and their dependents),

other than any such payment or series of payments which would have been paid if the employee's employment relationship had not been so terminated;

(14) any payment made by an employer to a survivor or the estate of a former employee after the calendar year in which such employee died;

(15) any payment made by an employer to an employee, if at the time such payment is made such employee is entitled to disability insurance benefits under section 223(a) of the Social Security Act and such entitlement commenced prior to the calendar year in which such payment is made, and if such employee did not perform any services for such employer during the period for which such payment is made;

(16) remuneration paid by an organization exempt from income tax under section 501(a) (other than an organization described in section 401(a)) or under section 521 in any calendar year to an employee for service rendered in the employ of such organization, if the remuneration paid in such year by the organization to the employee for such service is less than $100;

(17) any contribution, payment, or service provided by an employer which may be excluded from the gross income of an employee, his spouse, or his dependents, under the provisions of section 120 (relating to amounts received under qualified group legal services plans);

(18) any payment made, or benefit furnished, to or for the benefit of an employee if at the time of such payment or such furnishing it is reasonable to believe that the employee will be able to exclude such payment or benefit from income under section 127, 129, 134(b)(4), or 134(b)(5);

(19) the value of any meals or lodging furnished by or on behalf of the employer if at the time of such furnishing it is reasonable to believe that the employee will be able to exclude such items from income under section 119;

(20) any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under section 74(c), 108(f)(4), 117, or 132;

(21) in the case of a member of an Indian tribe, any remuneration on which no tax is imposed by this chapter by reason of section 7873 (relating to income derived by Indians from exercise of fishing rights);

(22) remuneration on account of—

(A) a transfer of a share of stock to any individual pursuant to an exercise of an incentive stock option (as defined in section 422(b)) or under an employee stock purchase plan (as defined in section 423(b)), or

(B) any disposition by the individual of such stock; or

(23) any benefit or payment which is excludable from the gross income of the employee under section 139B(b).

Nothing in the regulations prescribed for purposes of chapter 24 (relating to income tax withholding) which provides an exclusion from "wages" as used in such chapter shall be construed to require a similar exclusion from "wages" in the regulations prescribed for purposes of this chapter. Except as otherwise provided in regulations prescribed by the Secretary, any third party which makes a payment included in wages solely by reason of the parenthetical matter contained in subparagraph (A) of paragraph (2) shall be treated for purposes of this chapter and chapter 22 as the employer with respect to such wages.

**(b) Employment**

For purposes of this chapter, the term "employment" means any service, of whatever nature, performed (A) by an employee for the person employing him, irrespective of the citizenship or residence of either, (i) within the United States, or (ii) on or in connection with an American vessel or American aircraft under a contract of service which is entered into within the United States or during the performance of which and while the employee is employed on the vessel or aircraft it touches at a port in the United States, if the employee is employed on and in connection with such vessel or aircraft when outside the United States, or (B) outside the United States by a citizen or resident of the United States as an employee for an American employer (as defined in subsection (h)), or (C) if it is service, regardless of where or by whom performed, which is designated as employment or recognized as equivalent to employment under an agreement entered into under section 233 of the Social Security Act; except that such term shall not include—

(1) service performed by foreign agricultural workers lawfully admitted to the United States from the Bahamas, Jamaica, and the other British West Indies, or from any other foreign country or possession thereof, on a temporary basis to perform agricultural labor;

(2) domestic service performed in a local college club, or local chapter of a college fraternity or soror-

ity, by a student who is enrolled and is regularly attending classes at a school, college, or university;

(3)(A) service performed by a child under the age of 18 in the employ of his father or mother;

(B) service not in the course of the employer's trade or business, or domestic service in a private home of the employer, performed by an individual under the age of 21 in the employ of his father or mother, or performed by an individual in the employ of his spouse or son or daughter; except that the provisions of this subparagraph shall not be applicable to such domestic service performed by an individual in the employ of his son or daughter if—

(i) the employer is a surviving spouse or a divorced individual and has not remarried, or has a spouse living in the home who has a mental or physical condition which results in such spouse's being incapable of caring for a son, daughter, stepson, or stepdaughter (referred to in clause (ii)) for at least 4 continuous weeks in the calendar quarter in which the service is rendered, and

(ii) a son, daughter, stepson, or stepdaughter of such employer is living in the home, and

(iii) the son, daughter, stepson, or stepdaughter (referred to in clause (ii)) has not attained age 18 or has a mental or physical condition which requires the personal care and supervision of an adult for at least 4 continuous

weeks in the calendar quarter in which the service is rendered;

(4) service performed by an individual on or in connection with a vessel not an American vessel, or on or in connection with an aircraft not an American aircraft, if (A) the individual is employed on and in connection with such vessel or aircraft, when outside the United States and (B)(i) such individual is not a citizen of the United States or (ii) the employer is not an American employer;

(5) service performed in the employ of the United States or any instrumentality of the United States, if such service—

(A) would be excluded from the term "employment" for purposes of this title if the provisions of paragraphs (5) and (6) of this subsection as in effect in January 1983 had remained in effect, and

(B) is performed by an individual who—

(i) has been continuously performing service described in subparagraph (A) since December 31, 1983, and for purposes of this clause—

(I) if an individual performing service described in subparagraph (A) returns to the performance of such service after being separated therefrom for a period of less than 366 consecutive days, regardless of whether the period began before, on, or after December 31,

1983, then such service shall be considered continuous,

(II) if an individual performing service described in subparagraph (A) returns to the performance of such service after being detailed or transferred to an international organization as described under section 3343 of subchapter III of chapter 33 of title 5, United States Code, or under section 3581 of chapter 35 of such title, then the service performed for that organization shall be considered service described in subparagraph (A),

(III) if an individual performing service described in subparagraph (A) is reemployed or reinstated after being separated from such service for the purpose of accepting employment with the American Institute in Taiwan as provided under section 3310 of chapter 48 of title 22, United States Code, then the service performed for that Institute shall be considered service described in subparagraph (A),

(IV) if an individual performing service described in subparagraph (A) returns to the performance of such service after performing service as a member of a uniformed service (including, for purposes of this clause, service in the National Guard and temporary service in the Coast Guard Reserve) and after exercising restoration or reemployment rights as provided under chapter 43 of title 38, United States Code, then the service so performed as

a member of a uniformed service shall be considered service described in subparagraph (A), and

(V) if an individual performing service described in subparagraph (A) returns to the performance of such service after employment (by a tribal organization) to which section 105(e)(2)[1] of the Indian Self-Determination Act applies, then the service performed for that tribal organization shall be considered service described in subparagraph (A); or

(ii) is receiving an annuity from the Civil Service Retirement and Disability Fund, or benefits (for service as an employee) under another retirement system established by a law of the United States for employees of the Federal Government (other than for members of the uniformed service);

except that this paragraph shall not apply with respect to any such service performed on or after any date on which such individual performs—

(C) service performed as the President or Vice President of the United States,

(D) service performed—

(i) in a position placed in the Executive Schedule under sections 5312 through 5317 of title 5, United States Code,

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[1] See References in Text note below.

(ii) as a noncareer appointee in the Senior Executive Service or a noncareer member of the Senior Foreign Service, or

(iii) in a position to which the individual is appointed by the President (or his designee) or the Vice President under section 105(a)(1), 106(a)(1), or 107 (a)(1) or (b)(1) of title 3, United States Code, if the maximum rate of basic pay for such position is at or above the rate for level V of the Executive Schedule,

(E) service performed as the Chief Justice of the United States, an Associate Justice of the Supreme Court, a judge of a United States court of appeals, a judge of a United States district court (including the district court of a territory), a judge of the United States Court of Federal Claims, a judge of the United States Court of International Trade, a judge of the United States Tax Court, a United States magistrate judge, or a referee in bankruptcy or United States bankruptcy judge,

(F) service performed as a Member, Delegate, or Resident Commissioner of or to the Congress,

(G) any other service in the legislative branch of the Federal Government if such service—

(i) is performed by an individual who was not subject to subchapter III of chapter 83 of title 5, United States Code, or to another retirement system established by a law of the United States for employees of the Federal Govern-

ment (other than for members of the uniformed services), on December 31, 1983, or

(ii) is performed by an individual who has, at any time after December 31, 1983, received a lump-sum payment under section 8342(a) of title 5, United States Code, or under the corresponding provision of the law establishing the other retirement system described in clause (i), or

(iii) is performed by an individual after such individual has otherwise ceased to be subject to subchapter III of chapter 83 of title 5, United States Code (without having an application pending for coverage under such subchapter), while performing service in the legislative branch (determined without regard to the provisions of subparagraph (B) relating to continuity of employment), for any period of time after December 31, 1983,

and for purposes of this subparagraph (G) an individual is subject to such subchapter III or to any such other retirement system at any time only if (a) such individual's pay is subject to deductions, contributions, or similar payments (concurrent with the service being performed at that time) under section 8334(a) of such title 5 or the corresponding provision of the law establishing such other system, or (in a case to which section 8332(k)(1) of such title applies) such individual is making payments of amounts equivalent to such deductions, contributions, or similar payments while on leave without

pay, or (b) such individual is receiving an annuity from the Civil Service Retirement and Disability Fund, or is receiving benefits (for service as an employee) under another retirement system established by a law of the United States for employees of the Federal Government (other than for members of the uniformed services), or

(H) service performed by an individual—

(i) on or after the effective date of an election by such individual, under section 301 of the Federal Employees' Retirement System Act of 1986, section 307 of the Central Intelligence Agency Retirement Act (50 U.S.C. 2157), or the Federal Employees' Retirement System Open Enrollment Act of 1997[2] to become subject to the Federal Employees' Retirement System provided in chapter 84 of title 5, United States Code, or

(ii) on or after the effective date of an election by such individual, under regulations issued under section 860 of the Foreign Service Act of 1980, to become subject to the Foreign Service Pension System provided in subchapter II of chapter 8 of title I of such Act;

(6) service performed in the employ of the United States or any instrumentality of the United States if such service is performed—

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[2] So in original. Probably should be followed by a comma.

(A) in a penal institution of the United States by an inmate thereof;

(B) by any individual as an employee included under section 5351(2) of title 5, United States Code (relating to certain interns, student nurses, and other student employees of hospitals of the Federal Government), other than as a medical or dental intern or a medical or dental resident in training; or

(C) by any individual as an employee serving on a temporary basis in case of fire, storm, earthquake, flood, or other similar emergency;

(7) service performed in the employ of a State, or any political subdivision thereof, or any instrumentality of any one or more of the foregoing which is wholly owned thereby, except that this paragraph shall not apply in the case of—

(A) service which, under subsection (j), constitutes covered transportation service,

(B) service in the employ of the Government of Guam or the Government of American Samoa or any political subdivision thereof, or of any instrumentality of any one or more of the foregoing which is wholly owned thereby, performed by an officer or employee thereof (including a member of the legislature of any such Government or political subdivision), and, for purposes of this title with respect to the taxes imposed by this chapter—

(i) any person whose service as such an officer or employee is not covered by a retirement

system established by a law of the United States shall not, with respect to such service, be regarded as an employee of the United States or any agency or instrumentality thereof, and

(ii) the remuneration for service described in clause (i) (including fees paid to a public official) shall be deemed to have been paid by the Government of Guam or the Government of American Samoa or by a political subdivision thereof or an instrumentality of any one or more of the foregoing which is wholly owned thereby, whichever is appropriate,

(C) service performed in the employ of the District of Columbia or any instrumentality which is wholly owned thereby, if such service is not covered by a retirement system established by a law of the United States (other than the Federal Employees Retirement System provided in chapter 84 of title 5, United States Code); except that the provisions of this subparagraph shall not be applicable to service performed—

(i) in a hospital or penal institution by a patient or inmate thereof;

(ii) by any individual as an employee included under section 5351(2) of title 5, United States Code (relating to certain interns, student nurses, and other student employees of hospitals of the District of Columbia Government), other than as a medical or dental intern or as a medical or dental resident in training;

(iii) by any individual as an employee serving on a temporary basis in case of fire, storm, snow, earthquake, flood or other similar emergency; or

(iv) by a member of a board, committee, or council of the District of Columbia, paid on a per diem, meeting, or other fee basis,

(D) service performed in the employ of the Government of Guam (or any instrumentality which is wholly owned by such Government) by an employee properly classified as a temporary or intermittent employee, if such service is not covered by a retirement system established by a law of Guam; except that (i) the provisions of this subparagraph shall not be applicable to services performed by an elected official or a member of the legislature or in a hospital or penal institution by a patient or inmate thereof, and (ii) for purposes of this subparagraph, clauses (i) and (ii) of subparagraph (B) shall apply,

(E) service included under an agreement entered into pursuant to section 218 of the Social Security Act, or

(F) service in the employ of a State (other than the District of Columbia, Guam, or American Samoa), of any political subdivision thereof, or of any instrumentality of any one or more of the foregoing which is wholly owned thereby, by an individual who is not a member of a retirement system of such State, political subdivision, or instrumentality, ex-

cept that the provisions of this subparagraph shall not be applicable to service performed—

(i) by an individual who is employed to relieve such individual from unemployment;

(ii) in a hospital, home, or other institution by a patient or inmate thereof;

(iii) by any individual as an employee serving on a temporary basis in case of fire, storm, snow, earthquake, flood, or other similar emergency;

(iv) by an election official or election worker if the remuneration paid in a calendar year for such service is less than $1,000 with respect to service performed during any calendar year commencing on or after January 1, 1995, ending on or before December 31, 1999, and the adjusted amount determined under section 218(c)(8)(B) of the Social Security Act for any calendar year commencing on or after January 1, 2000, with respect to service performed during such calendar year; or

(v) by an employee in a position compensated solely on a fee basis which is treated pursuant to section 1402(c)(2)(E) as a trade or business for purposes of inclusion of such fees in net earnings from self-employment;

for purposes of this subparagraph, except as provided in regulations prescribed by the Secretary, the term "retirement system" has the meaning

given such term by section 218(b)(4) of the Social Security Act;

(8)(A) service performed by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order, except that this subparagraph shall not apply to service performed by a member of such an order in the exercise of such duties, if an election of coverage under subsection (r) is in effect with respect to such order, or with respect to the autonomous subdivision thereof to which such member belongs;

(B) service performed in the employ of a church or qualified church-controlled organization if such church or organization has in effect an election under subsection (w), other than service in an unrelated trade or business (within the meaning of section 513(a));

(9) service performed by an individual as an employee or employee representative as defined in section 3231;

(10) service performed in the employ of—

(A) a school, college, or university, or

(B) an organization described in section 509(a)(3) if the organization is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of a school, college, or university and is operated, supervised, or controlled by or in

connection with such school, college, or university, unless it is a school, college, or university of a State or a political subdivision thereof and the services performed in its employ by a student referred to in section 218(c)(5) of the Social Security Act are covered under the agreement between the Commissioner of Social Security and such State entered into pursuant to section 218 of such Act;

if such service is performed by a student who is enrolled and regularly attending classes at such school, college, or university;

(11) service performed in the employ of a foreign government (including service as a consular or other officer or employee or a nondiplomatic representative);

(12) service performed in the employ of an instrumentality wholly owned by a foreign government—

(A) if the service is of a character similar to that performed in foreign countries by employees of the United States Government or of an instrumentality thereof; and

(B) if the Secretary of State shall certify to the Secretary of the Treasury that the foreign government, with respect to whose instrumentality and employees thereof exemption is claimed, grants an equivalent exemption with respect to similar service performed in the foreign country by employees of the United States Government and of instrumentalities thereof;

(13) service performed as a student nurse in the employ of a hospital or a nurses' training school by an individual who is enrolled and is regularly attending classes in a nurses' training school chartered or approved pursuant to State law;

(14)(A) service performed by an individual under the age of 18 in the delivery or distribution of newspapers or shopping news, not including delivery or distribution to any point for subsequent delivery or distribution;

(B) service performed by an individual in, and at the time of, the sale of newspapers or magazines to ultimate consumers, under an arrangement under which the newspapers or magazines are to be sold by him at a fixed price, his compensation being based on the retention of the excess of such price over the amount at which the newspapers or magazines are charged to him, whether or not he is guaranteed a minimum amount of compensation for such service, or is entitled to be credited with the unsold newspapers or magazines turned back;

(15) service performed in the employ of an international organization, except service which constitutes "employment" under subsection (y);

(16) service performed by an individual under an arrangement with the owner or tenant of land pursuant to which—

(A) such individual undertakes to produce agricultural or horticultural commodities (including

livestock, bees, poultry, and fur-bearing animals and wildlife) on such land,

(B) the agricultural or horticultural commodities produced by such individual, or the proceeds therefrom, are to be divided between such individual and such owner or tenant, and

(C) the amount of such individual's share depends on the amount of the agricultural or horticultural commodities produced;

(17) service in the employ of any organization which is performed (A) in any year during any part of which such organization is registered, or there is in effect a final order of the Subversive Activities Control Board requiring such organization to register, under the Internal Security Act of 1950, as amended, as a Communist-action organization, a Communist-front organization, or a Communist-infiltrated organization, and (B) after June 30, 1956;

(18) service performed in Guam by a resident of the Republic of the Philippines while in Guam on a temporary basis as a nonimmigrant alien admitted to Guam pursuant to section 101(a)(15)(H)(ii) of the Immigration and Nationality Act (8 U.S.C. 1101(a)(15)(H)(ii));

(19) Service which is performed by a nonresident alien individual for the period he is temporarily present in the United States as a nonimmigrant under subparagraph (F), (J), (M), or (Q) of section 101(a)(15) of the Immigration and Nationality Act, as

amended, and which is performed to carry out the purpose specified in subparagraph (F), (J), (M), or (Q), as the case may be;

(20) service (other than service described in paragraph (3)(A)) performed by an individual on a boat engaged in catching fish or other forms of aquatic animal life under an arrangement with the owner or operator of such boat pursuant to which—

(A) such individual does not receive any cash remuneration other than as provided in subparagraph (B) and other than cash remuneration—

(i) which does not exceed $100 per trip;

(ii) which is contingent on a minimum catch; and

(iii) which is paid solely for additional duties (such as mate, engineer, or cook) for which additional cash remuneration is traditional in the industry,

(B) such individual receives a share of the boat's (or the boats' in the case of a fishing operation involving more than one boat) catch of fish or other forms of aquatic animal life or a share of the proceeds from the sale of such catch, and

(C) the amount of such individual's share depends on the amount of the boat's (or the boats' in the case of a fishing operation involving more than one boat) catch of fish or other forms of aquatic animal life,

but only if the operating crew of such boat (or each boat from which the individual receives a share in the case of a fishing operation involving more than one boat) is normally made up of fewer than 10 individuals; or

(21) domestic service in a private home of the employer which—

(A) is performed in any year by an individual under the age of 18 during any portion of such year; and

(B) is not the principal occupation of such employee.

For purposes of paragraph (20), the operating crew of a boat shall be treated as normally made up of fewer than 10 individuals if the average size of the operating crew on trips made during the preceding 4 calendar quarters consisted of fewer than 10 individuals.

**(c) Included and excluded service**

For purposes of this chapter, if the services performed during one-half or more of any pay period by an employee for the person employing him constitute employment, all the services of such employee for such period shall be deemed to be employment; but if the services performed during more than one-half of any such pay period by an employee for the person employing him do not constitute employment, then none of the services of such employee for such period shall be deemed to be employment. As used in this sub-

section, the term "pay period" means a period (of not more than 31 consecutive days) for which a payment of remuneration is ordinarily made to the employee by the person employing him. This subsection shall not be applicable with respect to services performed in a pay period by an employee for the person employing him, where any of such service is excepted by subsection (b)(9).

**(d) Employee**

For purposes of this chapter, the term "employee" means—

(1) any officer of a corporation; or

(2) any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee; or

(3) any individual (other than an individual who is an employee under paragraph (1) or (2)) who performs services for remuneration for any person—

(A) as an agent-driver or commission-driver engaged in distributing meat products, vegetable products, fruit products, bakery products, beverages (other than milk), or laundry or dry-cleaning services, for his principal;

(B) as a full-time life insurance salesman;

(C) as a home worker performing work, according to specifications furnished by the person for whom the services are performed, on materials or

goods furnished by such person which are required to be returned to such person or a person designated by him; or

(D) as a traveling or city salesman, other than as an agent-driver or commission-driver, engaged upon a full-time basis in the solicitation on behalf of, and the transmission to, his principal (except for side-line sales activities on behalf of some other person) of orders from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments for merchandise for resale or supplies for use in their business operations;

if the contract of service contemplates that substantially all of such services are to be performed personally by such individual; except that an individual shall not be included in the term "employee" under the provisions of this paragraph if such individual has a substantial investment in facilities used in connection with the performance of such services (other than in facilities for transportation), or if the services are in the nature of a single transaction not part of a continuing relationship with the person for whom the services are performed; or

(4) any individual who performs services that are included under an agreement entered into pursuant to section 218 of the Social Security Act.

**(e) State, United States, and citizen**

For purposes of this chapter—

**(1) State**

The term "State" includes the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, and American Samoa.

**(2) United States**

The term "United States" when used in a geographical sense includes the Commonwealth of Puerto Rico, the Virgin Islands, Guam, and American Samoa.

An individual who is a citizen of the Commonwealth of Puerto Rico (but not otherwise a citizen of the United States) shall be considered, for purposes of this section, as a citizen of the United States.

**(f) American vessel and aircraft**

For purposes of this chapter, the term "American vessel" means any vessel documented or numbered under the laws of the United States; and includes any vessel which is neither documented or numbered under the laws of the United States nor documented under the laws of any foreign country, if its crew is employed solely by one or more citizens or residents of the United States or corporations organized under the laws of the United States or of any State; and the term "American aircraft" means an aircraft registered under the laws of the United States.

**(g) Agricultural labor**

For purposes of this chapter, the term "agricultural labor" includes all service performed—

(1) on a farm, in the employ of any person, in connection with cultivating the soil, or in connection with raising or harvesting any agricultural or horticultural commodity, including the raising, shearing, feeding, caring for, training, and management of livestock, bees, poultry, and fur-bearing animals and wildlife;

(2) in the employ of the owner or tenant or other operator of a farm, in connection with the operation, management, conservation, improvement, or maintenance of such farm and its tools and equipment, or in salvaging timber or clearing land of brush and other debris left by a hurricane, if the major part of such service is performed on a farm;

(3) in connection with the production or harvesting of any commodity defined as an agricultural commodity in section 15(g) of the Agricultural Marketing Act, as amended (12 U.S.C. 1141j), or in connection with the ginning of cotton, or in connection with the operation or maintenance of ditches, canals, reservoirs, or waterways, not owned or operated for profit, used exclusively for supplying and storing water for farming purposes;

(4)(A) in the employ of the operator of a farm in handling, planting, drying, packing, packaging, processing, freezing, grading, storing, or delivering to

storage or to market or to a carrier for transportation to market, in its unmanufactured state, any agricultural or horticultural commodity; but only if such operator produced more than one-half of the commodity with respect to which such service is performed;

(B) in the employ of a group of operators of farms (other than a cooperative organization) in the performance of service described in subparagraph (A), but only if such operators produced all of the commodity with respect to which such service is performed. For purposes of this subparagraph, any unincorporated group of operators shall be deemed a cooperative organization if the number of operators comprising such group is more than 20 at any time during the calendar year in which such service is performed;

(C) the provisions of subparagraphs (A) and (B) shall not be deemed to be applicable with respect to service performed in connection with commercial canning or commercial freezing or in connection with any agricultural or horticultural commodity after its delivery to a terminal market for distribution for consumption; or

(5) on a farm operated for profit if such service is not in the course of the employer's trade or business.

As used in this subsection, the term "farm" includes stock, dairy, poultry, fruit, fur-bearing animal, and truck farms, plantations, ranches, nurseries, ranges, greenhouses or other similar structures used primarily

for the raising of agricultural or horticultural commodities, and orchards.

**(h) American employer**

For purposes of this chapter, the term "American employer" means an employer which is—

(1) the United States or any instrumentality thereof,

(2) an individual who is a resident of the United States,

(3) a partnership, if two-thirds or more of the partners are residents of the United States,

(4) a trust, if all of the trustees are residents of the United States, or

(5) a corporation organized under the laws of the United States or of any State.

**(i) Computation of wages in certain cases**

**(1) Domestic service**

For purposes of this chapter, in the case of domestic service described in subsection (a)(7)(B), any payment of cash remuneration for such service which is more or less than a whole-dollar amount shall, under such conditions and to such extent as may be prescribed by regulations made under this chapter, be computed to the nearest dollar. For the purpose of the computation to the nearest dollar, the payment of a fractional part of a dollar shall be disregarded unless it amounts to one-half dollar or

more, in which case it shall be increased to $1. The amount of any payment of cash remuneration so computed to the nearest dollar shall, in lieu of the amount actually paid, be deemed to constitute the amount of cash remuneration for purposes of subsection (a)(7)(B).

**(2) Service in the uniformed services**

For purposes of this chapter, in the case of an individual performing service, as a member of a uniformed service, to which the provisions of subsection (m)(1) are applicable, the term "wages" shall, subject to the provisions of subsection (a)(1) of this section, include as such individual's remuneration for such service only (A) his basic pay as described in chapter 3 and section 1009 of title 37, United States Code, in the case of an individual performing service to which subparagraph (A) of such subsection (m)(1) applies, or (B) his compensation for such service as determined under section 206(a) of title 37, United States Code, in the case of an individual performing service to which subparagraph (B) of such subsection (m)(1) applies.

**(3) Peace Corps volunteer service**

For purposes of this chapter, in the case of an individual performing service, as a volunteer or volunteer leader within the meaning of the Peace Corps Act, to which the provisions of section 3121(p) are applicable, the term "wages" shall, subject to the provisions of subsection (a)(1) of this section, include as such individual's remuneration

for such service only amounts paid pursuant to section 5(c) or 6(1) of the Peace Corps Act.

**(4) Service performed by certain members of religious orders**

For purposes of this chapter, in any case where an individual is a member of a religious order (as defined in subsection (r)(2)) performing service in the exercise of duties required by such order, and an election of coverage under subsection (r) is in effect with respect to such order or with respect to the autonomous subdivision thereof to which such member belongs, the term "wages" shall, subject to the provisions of subsection (a)(1), include as such individual's remuneration for such service the fair market value of any board, lodging, clothing, and other perquisites furnished to such member by such order or subdivision thereof or by any other person or organization pursuant to an agreement with such order or subdivision, except that the amount included as such individual's remuneration under this paragraph shall not be less than $100 a month.

**(5) Service performed by certain retired justices and judges**

For purposes of this chapter, in the case of an individual performing service under the provisions of section 294 of title 28, United States Code (relating to assignment of retired justices and judges to active duty), the term "wages" shall not include any pay-

ment under section 371(b) of such title 28 which is received during the period of such service.

**(j) Covered transportation service**

For purposes of this chapter—

**(1) Existing transportation systems—General rule**

Except as provided in paragraph (2), all service performed in the employ of a State or political subdivision in connection with its operation of a public transportation system shall constitute covered transportation service if any part of the transportation system was acquired from private ownership after 1936 and prior to 1951.

**(2) Existing transportation systems—Cases in which no transportation employees, or only certain employees, are covered**

Service performed in the employ of a State or political subdivision in connection with the operation of its public transportation system shall not constitute covered transportation service if—

(A) any part of the transportation system was acquired from private ownership after 1936 and prior to 1951, and substantially all service in connection with the operation of the transportation system was, on December 31, 1950, covered under a general retirement system providing benefits which, by reason of a provision of the State constitution dealing specifically with retirement systems of the State or political subdivisions thereof, cannot be diminished or impaired; or

(B) no part of the transportation system operated by the State or political subdivision on December 31, 1950, was acquired from private ownership after 1936 and prior to 1951;

except that if such State or political subdivision makes an acquisition after 1950 from private ownership of any part of its transportation system, then, in the case of any employee who—

(C) became an employee of such State or political subdivision in connection with and at the time of its acquisition after 1950 of such part, and

(D) prior to such acquisition rendered service in employment (including as employment service covered by an agreement under section 218 of the Social Security Act) in connection with the operation of such part of the transportation system acquired by the State or political subdivision,

the service of such employee in connection with the operation of the transportation system shall constitute covered transportation service, commencing with the first day of the third calendar quarter following the calendar quarter in which the acquisition of such part took place, unless on such first day such service of such employee is covered by a general retirement system which does not, with respect to such employee, contain special provisions applicable only to employees described in subparagraph (C).

**(3) Transportation systems acquired after 1950**

All service performed in the employ of a State or political subdivision thereof in connection with its operation of a public transportation system shall constitute covered transportation service if the transportation system was not operated by the State or political subdivision prior to 1951 and, at the time of its first acquisition (after 1950) from private ownership of any part of its transportation system, the State or political subdivision did not have a general retirement system covering substantially all service performed in connection with the operation of the transportation system.

**(4) Definitions**

For purposes of this subsection—

(A) The term "general retirement system" means any pension, annuity, retirement, or similar fund or system established by a State or by a political subdivision thereof for employees of the State, political subdivision, or both; but such term shall not include such a fund or system which covers only service performed in positions connected with the operation of its public transportation system.

(B) A transportation system or a part thereof shall be considered to have been acquired by a State or political subdivision from private ownership if prior to the acquisition service performed by employees in connection with the operation of the system or part thereof acquired constituted employment under this chapter or subchapter A of

chapter 9 of the Internal Revenue Code of 1939 or was covered by an agreement made pursuant to section 218 of the Social Security Act and some of such employees became employees of the State or political subdivision in connection with and at the time of such acquisition.

(C) The term "political subdivision" includes an instrumentality of—

(i) a State,

(ii) one or more political subdivisions of a State, or

(iii) a State and one or more of its political subdivisions.

**[(k) Repealed. Pub. L. 98–21, title I, §102(b)(2), Apr. 20, 1983, 97 Stat. 71]**

**(*l*) Agreements entered into by American employers with respect to foreign affiliates**

**(1) Agreement with respect to certain employees of foreign affiliate**

The Secretary shall, at the American employer's request, enter into an agreement (in such manner and form as may be prescribed by the Secretary) with any American employer (as defined in subsection (h)) who desires to have the insurance system established by title II of the Social Security Act extended to service performed outside the United States in the employ of any 1 or more of such employer's foreign affiliates (as defined in paragraph (6)) by all employees who are citizens or residents of

the United States, except that the agreement shall not apply to any service performed by, or remuneration paid to, an employee if such service or remuneration would be excluded from the term "employment" or "wages", as defined in this section, had the service been performed in the United States. Such agreement may be amended at any time so as to be made applicable, in the same manner and under the same conditions, with respect to any other foreign affiliate of such American employer. Such agreement shall be applicable with respect to citizens or residents of the United States who, on or after the effective date of the agreement, are employees of and perform services outside the United States for any foreign affiliate specified in the agreement. Such agreement shall provide—

(A) that the American employer shall pay to the Secretary, at such time or times as the Secretary may by regulations prescribe, amounts equivalent to the sum of the taxes which would be imposed by sections 3101 and 3111 (including amounts equivalent to the interest, additions to the taxes, additional amounts, and penalties which would be applicable) with respect to the remuneration which would be wages if the services covered by the agreement constituted employment as defined in this section; and

(B) that the American employer will comply with such regulations relating to payments and reports as the Secretary may prescribe to carry out the purposes of this subsection.

**(2) Effective period of agreement**

An agreement entered into pursuant to paragraph (1) shall be in effect for the period beginning with the first day of the calendar quarter in which such agreement is entered into or the first day of the succeeding calendar quarter, as may be specified in the agreement; except that in case such agreement is amended to include the services performed for any other affiliate and such amendment is executed after the first month following the first calendar quarter for which the agreement is in effect, the agreement shall be in effect with respect to service performed for such other affiliate only after the calendar quarter in which such amendment is executed. Notwithstanding any other provision of this subsection, the period for which any such agreement is effective with respect to any foreign entity shall terminate at the end of any calendar quarter in which the foreign entity, at any time in such quarter, ceases to be a foreign affiliate as defined in paragraph (6).

**(3) No termination of agreement**

No agreement under this subsection may be terminated, either in its entirety or with respect to any foreign affiliate, on or after June 15, 1989.

**(4) Deposits in trust funds**

For purposes of section 201 of the Social Security Act, relating to appropriations to the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund, such remuneration—

(A) paid for services covered by an agreement entered into pursuant to paragraph (1) as would be wages if the services constituted employment, and

(B) as is reported to the Secretary pursuant to the provisions of such agreement or of the regulations issued under this subsection,

shall be considered wages subject to the taxes imposed by this chapter.

**(5) Overpayments and underpayments**

(A) If more or less than the correct amount due under an agreement entered into pursuant to this subsection is paid with respect to any payment of remuneration, proper adjustments with respect to the amounts due under such agreement shall be made, without interest, in such manner and at such times as may be required by regulations prescribed by the Secretary.

(B) If an overpayment cannot be adjusted under subparagraph (A), the amount thereof shall be paid by the Secretary, through the Fiscal Service of the Treasury Department, but only if a claim for such overpayment is filed with the Secretary within two years from the time such overpayment was made.

**(6) Foreign affiliate defined**

For purposes of this subsection and section 210(a) of the Social Security Act—

**(A) In general**

A foreign affiliate of an American employer is any foreign entity in which such American employer has not less than a 10-percent interest.

**(B) Determination of 10-percent interest**

For purposes of subparagraph (A), an American employer has a 10-percent interest in any entity if such employer has such an interest directly (or through one or more entities)—

(i) in the case of a corporation, in the voting stock thereof, and

(ii) in the case of any other entity, in the profits thereof.

**(7) American employer as separate entity**

Each American employer which enters into an agreement pursuant to paragraph (1) of this subsection shall, for purposes of this subsection and section 6413(c)(2)(C), relating to special refunds in the case of employees of certain foreign entities, be considered an employer in its capacity as a party to such agreement separate and distinct from its identity as a person employing individuals on its own account.

**(8) Regulations**

Regulations of the Secretary to carry out the purposes of this subsection shall be designed to make the requirements imposed on American employers with respect to services covered by an agreement

entered into pursuant to this subsection the same, so far as practicable, as those imposed upon employers pursuant to this title with respect to the taxes imposed by this chapter.

**(m) Service in the uniformed services**

For purposes of this chapter—

**(1) Inclusion of service**

The term "employment" shall, notwithstanding the provisions of subsection (b) of this section, include—

(A) service performed by an individual as a member of a uniformed service on active duty, but such term shall not include any such service which is performed while on leave without pay, and

(B) service performed by an individual as a member of a uniformed service on inactive duty training.

**(2) Active duty**

The term "active duty" means "active duty" as described in paragraph (21) of section 101 of title 38, United States Code, except that it shall also include "active duty for training" as described in paragraph (22) of such section.

**(3) Inactive duty training**

The term "inactive duty training" means "inactive duty training" as described in paragraph (23) of such section 101.

**(n) Member of a uniformed service**

For purposes of this chapter, the term "member of a uniformed service" means any person appointed, enlisted, or inducted in a component of the Army, Navy, Air Force, Marine Corps, or Coast Guard (including a reserve component as defined in section 101(27) of title 38, United States Code), or in one of those services without specification of component, or as a commissioned officer of the Coast and Geodetic Survey, the National Oceanic and Atmospheric Administration Corps, or the Regular or Reserve Corps of the Public Health Service, and any person serving in the Army or Air Force under call or conscription. The term includes—

(1) a retired member of any of those services;

(2) a member of the Fleet Reserve or Fleet Marine Corps Reserve;

(3) a cadet at the United States Military Academy, a midshipman at the United States Naval Academy, and a cadet at the United States Coast Guard Academy or United States Air Force Academy;

(4) a member of the Reserve Officers' Training Corps, the Naval Reserve Officers' Training Corps, or the Air Force Reserve Officers' Training Corps, when ordered to annual training duty for fourteen days or more, and while performing authorized travel to and from that duty; and

(5) any person while en route to or from, or at, a place for final acceptance or for entry upon active duty in the military, naval, or air service—

(A) who has been provisionally accepted for such duty; or

(B) who, under the Military Selective Service Act, has been selected for active military, naval, or air service;

and has been ordered or directed to proceed to such place.

The term does not include a temporary member of the Coast Guard Reserve.

**(*o*) Crew leader**

For purposes of this chapter, the term "crew leader" means an individual who furnishes individuals to perform agricultural labor for another person, if such individual pays (either on his own behalf or on behalf of such person) the individuals so furnished by him for the agricultural labor performed by them and if such individual has not entered into a written agreement with such person whereby such individual has been designated as an employee of such person; and such individuals furnished by the crew leader to perform agricultural labor for another person shall be deemed to be the employees of such crew leader. For purposes of this chapter and chapter 2, a crew leader shall, with respect to service performed in furnishing individuals to perform agricultural labor for another person and service performed as a member of the

crew, be deemed not to be an employee of such other person.

**(p) Peace Corps volunteer service**

For purposes of this chapter, the term "employment" shall, notwithstanding the provisions of subsection (b) of this section, include service performed by an individual as a volunteer or volunteer leader within the meaning of the Peace Corps Act.

**(q) Tips included for both employee and employer taxes**

For purposes of this chapter, tips received by an employee in the course of his employment shall be considered remuneration for such employment (and deemed to have been paid by the employer for purposes of subsections (a) and (b) of section 3111). Such remuneration shall be deemed to be paid at the time a written statement including such tips is furnished to the employer pursuant to section 6053(a) or (if no statement including such tips is so furnished) at the time received; except that, in determining the employer's liability in connection with the taxes imposed by section 3111 with respect to such tips in any case where no statement including such tips was so furnished (or to the extent that the statement so furnished was inaccurate or incomplete), such remuneration shall be deemed for purposes of subtitle F to be paid on the date on which notice and demand for such taxes is made to the employer by the Secretary.

**(r) Election of coverage by religious orders**

**(1) Certificate of election by order**

A religious order whose members are required to take a vow of poverty, or any autonomous subdivision of such order, may file a certificate (in such form and manner, and with such official, as may be prescribed by regulations under this chapter) electing to have the insurance system established by title II of the Social Security Act extended to services performed by its members in the exercise of duties required by such order or such subdivision thereof. Such certificate of election shall provide that—

(A) such election of coverage by such order or subdivision shall be irrevocable;

(B) such election shall apply to all current and future members of such order, or in the case of a subdivision thereof to all current and future members of such order who belong to such subdivision;

(C) all services performed by a member of such an order or subdivision in the exercise of duties required by such order or subdivision shall be deemed to have been performed by such member as an employee of such order or subdivision; and

(D) the wages of each member, upon which such order or subdivision shall pay the taxes imposed by sections 3101 and 3111, will be determined as provided in subsection (i)(4).

**(2) Definition of member**

For purposes of this subsection, a member of a religious order means any individual who is subject to a vow of poverty as a member of such order and who performs tasks usually required (and to the extent usually required) of an active member of such order and who is not considered retired because of old age or total disability.

**(3) Effective date for election**

(A) A certificate of election of coverage shall be in effect, for purposes of subsection (b)(8) and for purposes of section 210(a)(8) of the Social Security Act, for the period beginning with whichever of the following may be designated by the order or subdivision thereof:

(i) the first day of the calendar quarter in which the certificate is filed,

(ii) the first day of the calendar quarter succeeding such quarter, or

(iii) the first day of any calendar quarter preceding the calendar quarter in which the certificate is filed, except that such date may not be earlier than the first day of the twentieth calendar quarter preceding the quarter in which such certificate is filed.

Whenever a date is designated under clause (iii), the election shall apply to services performed before the quarter in which the certificate is filed only if the member performing such services was a

member at the time such services were performed and is living on the first day of the quarter in which such certificate is filed.

(B) If a certificate of election filed pursuant to this subsection is effective for one or more calendar quarters prior to the quarter in which such certificate is filed, then—

(i) for purposes of computing interest and for purposes of section 6651 (relating to addition to tax for failure to file tax return), the due date for the return and payment of the tax for such prior calendar quarters resulting from the filing of such certificate shall be the last day of the calendar month following the calendar quarter in which the certificate is filed; and

(ii) the statutory period for the assessment of such tax shall not expire before the expiration of 3 years from such due date.

**[(4) Repealed. Pub. L. 98–21, title I, §102(b)(3)(B), Apr. 20, 1983, 97 Stat. 71]**

**(s) Concurrent employment by two or more employers**

For purposes of sections 3102, 3111, and 3121(a)(1), if two or more related corporations concurrently employ the same individual and compensate such individual through a common paymaster which is one of such corporations, each such corporation shall be considered to have paid as remuneration to such individual only the amounts actually disbursed by it to such individual and shall not be considered to have paid as

remuneration to such individual amounts actually disbursed to such individual by another of such corporations.

**[(t) Repealed. Pub. L. 100–203, title IX, §9006(b)(2), Dec. 22, 1987, 101 Stat. 1330–289]**

**(u) Application of hospital insurance tax to Federal, State, and local employment**

**(1) Federal employment**

For purposes of the taxes imposed by sections 3101(b) and 3111(b), subsection (b) shall be applied without regard to paragraph (5) thereof.

**(2) State and local employment**

For purposes of the taxes imposed by sections 3101(b) and 3111(b)—

**(A) In general**

Except as provided in subparagraphs (B) and (C), subsection (b) shall be applied without regard to paragraph (7) thereof.

**(B) Exception for certain services**

Service shall not be treated as employment by reason of subparagraph (A) if—

(i) the service is included under an agreement under section 218 of the Social Security Act, or

(ii) the service is performed—

(I) by an individual who is employed by a State or political subdivision thereof to relieve him from unemployment,

(II) in a hospital, home, or other institution by a patient or inmate thereof as an employee of a State or political subdivision thereof or of the District of Columbia,

(III) by an individual, as an employee of a State or political subdivision thereof or of the District of Columbia, serving on a temporary basis in case of fire, storm, snow, earthquake, flood or other similar emergency,

(IV) by any individual as an employee included under section 5351(2) of title 5, United States Code (relating to certain interns, student nurses, and other student employees of hospitals of the District of Columbia Government), other than as a medical or dental intern or a medical or dental resident in training,

(V) by an election official or election worker if the remuneration paid in a calendar year for such service is less than $1,000 with respect to service performed during any calendar year commencing on or after January 1, 1995, ending on or before December 31, 1999, and the adjusted amount determined under section 218(c)(8)(B) of the Social Security Act for any calendar year commencing on or after January 1, 2000, with respect to service performed during such calendar year, or

(VI) by an individual in a position described in section 1402(c)(2)(E).

As used in this subparagraph, the terms "State" and "political subdivision" have the meanings given those terms in section 218(b) of the Social Security Act.

**(C) Exception for current employment which continues**

Service performed for an employer shall not be treated as employment by reason of subparagraph (A) if—

(i) such service would be excluded from the term "employment" for purposes of this chapter if subparagraph (A) did not apply;

(ii) such service is performed by an individual—

(I) who was performing substantial and regular service for remuneration for that employer before April 1, 1986,

(II) who is a bona fide employee of that employer on March 31, 1986, and

(III) whose employment relationship with that employer was not entered into for purposes of meeting the requirements of this subparagraph; and

(iii) the employment relationship with that employer has not been terminated after March 31, 1986.

**(D) Treatment of agencies and instrumentalities**

For purposes of subparagraph (C), under regulations—

(i) All agencies and instrumentalities of a State (as defined in section 218(b) of the Social Security Act) or of the District of Columbia shall be treated as a single employer.

(ii) All agencies and instrumentalities of a political subdivision of a State (as so defined) shall be treated as a single employer and shall not be treated as described in clause (i).

**(3) Medicare qualified government employment**

For purposes of this chapter, the term "medicare qualified government employment" means service which—

(A) is employment (as defined in subsection (b)) with the application of paragraphs (1) and (2), but

(B) would not be employment (as so defined) without the application of such paragraphs.

**(v) Treatment of certain deferred compensation and salary reduction arrangements**

**(1) Certain employer contributions treated as wages**

Nothing in any paragraph of subsection (a) (other than paragraph (1)) shall exclude from the term "wages"—

(A) any employer contribution under a qualified cash or deferred arrangement (as defined in section

401(k)) to the extent not included in gross income by reason of section 402(e)(3) or consisting of designated Roth contributions (as defined in section 402A(c)), or

(B) any amount treated as an employer contribution under section 414(h)(2) where the pickup referred to in such section is pursuant to a salary reduction agreement (whether evidenced by a written instrument or otherwise).

**(2) Treatment of certain nonqualified deferred compensation plans**

**(A) In general**

Any amount deferred under a nonqualified deferred compensation plan shall be taken into account for purposes of this chapter as of the later of—

(i) when the services are performed, or

(ii) when there is no substantial risk of forfeiture of the rights to such amount.

The preceding sentence shall not apply to any excess parachute payment (as defined in section 280G(b)) or to any specified stock compensation (as defined in section 4985) on which tax is imposed by section 4985.

**(B) Taxed only once**

Any amount taken into account as wages by reason of subparagraph (A) (and the income attributa-

ble thereto) shall not thereafter be treated as wages for purposes of this chapter.

**(C) Nonqualified deferred compensation plan**

For purposes of this paragraph, the term "nonqualified deferred compensation plan" means any plan or other arrangement for deferral of compensation other than a plan described in subsection (a)(5).

**(3) Exempt governmental deferred compensation plan**

For purposes of subsection (a)(5), the term "exempt governmental deferred compensation plan" means any plan providing for deferral of compensation established and maintained for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing. Such term shall not include—

(A) any plan to which section 83, 402(b), 403(c), 457(a), or 457(f)(1) applies,

(B) any annuity contract described in section 403(b), and

(C) the Thrift Savings Fund (within the meaning of subchapter III of chapter 84 of title 5, United States Code).

**(w) Exemption of churches and qualified church-controlled organizations**

**(1) General rule**

Any church or qualified church-controlled organization (as defined in paragraph (3)) may make an election within the time period described in paragraph (2), in accordance with such procedures as the Secretary determines to be appropriate, that services performed in the employ of such church or organization shall be excluded from employment for purposes of title II of the Social Security Act and this chapter. An election may be made under this subsection only if the church or qualified church-controlled organization states that such church or organization is opposed for religious reasons to the payment of the tax imposed under section 3111.

**(2) Timing and duration of election**

An election under this subsection must be made prior to the first date, more than 90 days after July 18, 1984, on which a quarterly employment tax return for the tax imposed under section 3111 is due, or would be due but for the election, from such church or organization. An election under this subsection shall apply to current and future employees, and shall apply to service performed after December 31, 1983. The election may be revoked by the church or organization under regulations prescribed by the Secretary. The election shall be revoked by the Secretary if such church or organization fails to furnish the information required under section 6051 to

the Secretary for a period of 2 years or more with respect to remuneration paid for such services by such church or organization, and, upon request by the Secretary, fails to furnish all such previously unfurnished information for the period covered by the election. Any revocation under the preceding sentence shall apply retroactively to the beginning of the 2-year period for which the information was not furnished.

**(3) Definitions**

(A) For purposes of this subsection, the term "church" means a church, a convention or association of churches, or an elementary or secondary school which is controlled, operated, or principally supported by a church or by a convention or association of churches.

(B) For purposes of this subsection, the term "qualified church-controlled organization" means any church-controlled tax-exempt organization described in section 501(c)(3), other than an organization which—

(i) offers goods, services, or facilities for sale, other than on an incidental basis, to the general public, other than goods, services, or facilities which are sold at a nominal charge which is substantially less than the cost of providing such goods, services, or facilities; and

(ii) normally receives more than 25 percent of its support from either (I) governmental sources, or (II) receipts from admissions, sales of merchandise,

performance of services, or furnishing of facilities, in activities which are not unrelated trades or businesses, or both.

**(x) Applicable dollar threshold**

For purposes of subsection (a)(7)(B), the term "applicable dollar threshold" means $1,000. In the case of calendar years after 1995, the Commissioner of Social Security shall adjust such $1,000 amount at the same time and in the same manner as under section 215(a)(1)(B)(ii) of the Social Security Act with respect to the amounts referred to in section 215(a)(1)(B)(i) of such Act, except that, for purposes of this paragraph, 1993 shall be substituted for the calendar year referred to in section 215(a)(1)(B)(ii)(II) of such Act. If any amount as adjusted under the preceding sentence is not a multiple of $100, such amount shall be rounded to the next lowest multiple of $100.

**(y) Service in the employ of international organizations by certain transferred Federal employees**

**(1) In general**

For purposes of this chapter, service performed in the employ of an international organization by an individual pursuant to a transfer of such individual to such international organization pursuant to section 3582 of title 5, United States Code, shall constitute "employment" if—

(A) immediately before such transfer, such individual performed service with a Federal agency which constituted "employment" under subsection

(b) for purposes of the taxes imposed by sections 3101(a) and 3111(a), and

(B) such individual would be entitled, upon separation from such international organization and proper application, to reemployment with such Federal agency under such section 3582.

**(2) Definitions**

For purposes of this subsection—

**(A) Federal agency**

The term "Federal agency" means an agency, as defined in section 3581(1) of title 5, United States Code.

**(B) International organization**

The term "international organization" has the meaning provided such term by section 3581(3) of title 5, United States Code.

**(z) Treatment of certain foreign persons as American employers**

**(1) In general**

If any employee of a foreign person is performing services in connection with a contract between the United States Government (or any instrumentality thereof) and any member of any domestically controlled group of entities which includes such foreign person, such foreign person shall be treated for purposes of this chapter as an American employer with respect to such services performed by such employee.

**(2) Domestically controlled group of entities**

For purposes of this subsection—

**(A) In general**

The term "domestically controlled group of entities" means a controlled group of entities the common parent of which is a domestic corporation.

**(B) Controlled group of entities**

The term "controlled group of entities" means a controlled group of corporations as defined in section 1563(a)(1), except that—

(i) "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears therein, and

(ii) the determination shall be made without regard to subsections (a)(4) and (b)(2) of section 1563.

A partnership or any other entity (other than a corporation) shall be treated as a member of a controlled group of entities if such entity is controlled (within the meaning of section 954(d)(3)) by members of such group (including any entity treated as a member of such group by reason of this sentence).

**(3) Liability of common parent**

In the case of a foreign person who is a member of any domestically controlled group of entities, the common parent of such group shall be jointly and

severally liable for any tax under this chapter for which such foreign person is liable by reason of this subsection, and for any penalty imposed on such person by this title with respect to any failure to pay such tax or to file any return or statement with respect to such tax or wages subject to such tax. No deduction shall be allowed under this title for any liability imposed by the preceding sentence.

**(4) Provisions preventing double taxation**

**(A) Agreements**

Paragraph (1) shall not apply to any services which are covered by an agreement under subsection (*l*).

**(B) Equivalent foreign taxation**

Paragraph (1) shall not apply to any services if the employer establishes to the satisfaction of the Secretary that the remuneration paid by such employer for such services is subject to a tax imposed by a foreign country which is substantially equivalent to the taxes imposed by this chapter.

**(5) Cross reference**

**For relief from taxes in cases covered by certain international agreements, see sections 3101(c) and 3111(c).**

3. 26 U.S.C. 3401 (2006 & Supp. V 2011) provides:

**Definitions**

**(a) Wages**

For purposes of this chapter, the term "wages" means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include remuneration paid—

(1) for active service performed in a month for which such employee is entitled to the benefits of section 112 (relating to certain combat zone compensation of members of the Armed Forces of the United States) to the extent remuneration for such service is excludable from gross income under such section; or

(2) for agricultural labor (as defined in section 3121(g)) unless the remuneration paid for such labor is wages (as defined in section 3121(a)); or

(3) for domestic service in a private home, local college club, or local chapter of a college fraternity or sorority; or

(4) for service not in the course of the employer's trade or business performed in any calendar quarter by an employee, unless the cash remuneration paid for such service is $50 or more and such service is performed by an individual who is regularly employed by such employer to perform such service. For purposes of this paragraph, an individual shall

be deemed to be regularly employed by an employer during a calendar quarter only if—

(A) on each of some 24 days during such quarter such individual performs for such employer for some portion of the day service not in the course of the employer's trade or business; or

(B) such individual was regularly employed (as determined under subparagraph (A)) by such employer in the performance of such service during the preceding calendar quarter; or

(5) for services by a citizen or resident of the United States for a foreign government or an international organization; or

(6) for such services, performed by a nonresident alien individual, as may be designated by regulations prescribed by the Secretary; or

[(7) Repealed. Pub. L. 89-809, title I, §103(k), Nov. 13, 1966, 80 Stat. 1554]

(8)(A) for services for an employer (other than the United States or any agency thereof)—

(i) performed by a citizen of the United States if, at the time of the payment of such remuneration, it is reasonable to believe that such remuneration will be excluded from gross income under section 911; or

(ii) performed in a foreign country or in a possession of the United States by such a citizen if, at the time of the payment of such remuneration, the

employer is required by the law of any foreign country or possession of the United States to withhold income tax upon such remuneration; or

(B) for services for an employer (other than the United States or any agency thereof) performed by a citizen of the United States within a possession of the United States (other than Puerto Rico), if it is reasonable to believe that at least 80 percent of the remuneration to be paid to the employee by such employer during the calendar year will be for such services; or

(C) for services for an employer (other than the United States or any agency thereof) performed by a citizen of the United States within Puerto Rico, if it is reasonable to believe that during the entire calendar year the employee will be a bona fide resident of Puerto Rico; or

(D) for services for the United States (or any agency thereof) performed by a citizen of the United States within a possession of the United States to the extent the United States (or such agency) withholds taxes on such remuneration pursuant to an agreement with such possession; or

(9) for services performed by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order; or

(10)(A) for services performed by an individual under the age of 18 in the delivery or distribution of newspapers or shopping news, not including delivery or distribution to any point for subsequent delivery or distribution; or

(B) for services performed by an individual in, and at the time of, the sale of newspapers or magazines to ultimate consumers, under an arrangement under which the newspapers or magazines are to be sold by him at a fixed price, his compensation being based on the retention of the excess of such price over the amount at which the newspapers or magazines are charged to him, whether or not he is guaranteed a minimum amount of compensation for such services, or is entitled to be credited with the unsold newspapers or magazines turned back; or

(11) for services not in the course of the employer's trade or business, to the extent paid in any medium other than cash; or

(12) to, or on behalf of, an employee or his beneficiary—

(A) from or to a trust described in section 401(a) which is exempt from tax under section 501(a) at the time of such payment unless such payment is made to an employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust; or

(B) under or to an annuity plan which, at the time of such payment, is a plan described in section 403(a); or

(C) for a payment described in section 402(h)(1) and (2) if, at the time of such payment, it is reasonable to believe that the employee will be entitled to an exclusion under such section for payment; or

(D) under an arrangement to which section 408(p) applies; or

(E) under or to an eligible deferred compensation plan which, at the time of such payment, is a plan described in section 457(b) which is maintained by an eligible employer described in section 457(e)(1)(A),[1] or

(13) pursuant to any provision of law other than section 5(c) or 6(1) of the Peace Corps Act, for service performed as a volunteer or volunteer leader within the meaning of such Act; or

(14) in the form of group-term life insurance on the life of an employee; or

(15) to or on behalf of an employee if (and to the extent that) at the time of the payment of such remuneration it is reasonable to believe that a corresponding deduction is allowable under section 217 (determined without regard to section 274(n)); or

(16)(A) as tips in any medium other than cash;

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[1] So in original. The comma probably should be a semicolon.

(B) as cash tips to an employee in any calendar month in the course of his employment by an employer unless the amount of such cash tips is $20 or more;[2]

(17) for service described in section 3121(b)(20);[2]

(18) for any payment made, or benefit furnished, to or for the benefit of an employee if at the time of such payment or such furnishing it is reasonable to believe that the employee will be able to exclude such payment or benefit from income under section 127, 129, 134(b)(4), or 134(b)(5);[2]

(19) for any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under section 74(c), 108(f)(4), 117, or 132;[2]

(20) for any medical care reimbursement made to or for the benefit of an employee under a self-insured medical reimbursement plan (within the meaning of section 105(h)(6));[2]

(21) for any payment made to or for the benefit of an employee if at the time of such payment it is reasonable to believe that the employee will be able to exclude such payment from income under section 106(b);[2]

(22) any payment made to or for the benefit of an employee if at the time of such payment it is reason-

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[2] So in original. Probably should be followed by "or".

able to believe that the employee will be able to exclude such payment from income under section 106(d); or

(23) for any benefit or payment which is excludable from the gross income of the employee under section 139B(b).

The term "wages" includes any amount includible in gross income of an employee under section 409A and payment of such amount shall be treated as having been made in the taxable year in which the amount is so includible.

**(b) Payroll period**

For purposes of this chapter, the term "payroll period" means a period for which a payment of wages is ordinarily made to the employee by his employer, and the term "miscellaneous payroll period" means a payroll period other than a daily, weekly, biweekly, semimonthly, monthly, quarterly, semiannual or annual payroll period.

**(c) Employee**

For purposes of this chapter, the term "employee" includes an officer, employee, or elected official of the United States, a State, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing. The term "employee" also includes an officer of a corporation.

**(d) Employer**

For purposes of this chapter, the term "employer" means the person for whom an individual performs or performed any service, of whatever nature, as the employee of such person, except that—

(1) if the person for whom the individual performs or performed the services does not have control of the payment of the wages for such services, the term "employer" (except for purposes of subsection (a)) means the person having control of the payment of such wages, and

(2) in the case of a person paying wages on behalf of a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, the term "employer" (except for purposes of subsection (a)) means such person.

**(e) Number of withholding exemptions claimed**

For purposes of this chapter, the term "number of withholding exemptions claimed" means the number of withholding exemptions claimed in a withholding exemption certificate in effect under section 3402(f), or in effect under the corresponding section of prior law, except that if no such certificate is in effect, the number of withholding exemptions claimed shall be considered to be zero.

**(f) Tips**

For purposes of subsection (a), the term "wages" includes tips received by an employee in the course of his

employment. Such wages shall be deemed to be paid at the time a written statement including such tips is furnished to the employer pursuant to section 6053(a) or (if no statement including such tips is so furnished) at the time received.

**(g) Crew leader rules to apply**

Rules similar to the rules of section 3121(*o*) shall apply for purposes of this chapter.

**(h) Differential wage payments to active duty members of the uniformed services**

**(1) In general**

For purposes of subsection (a), any differential wage payment shall be treated as a payment of wages by the employer to the employee.

**(2) Differential wage payment**

For purposes of paragraph (1), the term "differential wage payment" means any payment which—

(A) is made by an employer to an individual with respect to any period during which the individual is performing service in the uniformed services (as defined in chapter 43 of title 38, United States Code) while on active duty for a period of more than 30 days, and

(B) represents all or a portion of the wages the individual would have received from the employer if the individual were performing service for the employer.

4. 26 U.S.C. 3402 (2006 & Supp. V 2011) provides:

**Income tax collected at source**

**(a) Requirement of withholding**

**(1) In general**

Except as otherwise provided in this section, every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary. Any tables or procedures prescribed under this paragraph shall—

(A) apply with respect to the amount of wages paid during such periods as the Secretary may prescribe, and

(B) be in such form, and provide for such amounts to be deducted and withheld, as the Secretary determines to be most appropriate to carry out the purposes of this chapter and to reflect the provisions of chapter 1 applicable to such periods.

**(2) Amount of wages**

For purposes of applying tables or procedures prescribed under paragraph (1), the term "the amount of wages" means the amount by which the wages exceed the number of withholding exemptions claimed multiplied by the amount of one such exemption. The amount of each withholding exemption shall be equal to the amount of one per-

sonal exemption provided in section 151(b), prorated to the payroll period. The maximum number of withholding exemptions permitted shall be calculated in accordance with regulations prescribed by the Secretary under this section, taking into account any reduction in withholding to which an employee is entitled under this section.

**(b) Percentage method of withholding**

(1) If wages are paid with respect to a period which is not a payroll period, the withholding exemption allowable with respect to each payment of such wages shall be the exemption allowed for a miscellaneous payroll period containing a number of days (including Sundays and holidays) equal to the number of days in the period with respect to which such wages are paid.

(2) In any case in which wages are paid by an employer without regard to any payroll period or other period, the withholding exemption allowable with respect to each payment of such wages shall be the exemption allowed for a miscellaneous payroll period containing a number of days equal to the number of days (including Sundays and holidays) which have elapsed since the date of the last payment of such wages by such employer during the calendar year, or the date of commencement of employment with such employer during such year, or January 1 of such year, whichever is the later.

(3) In any case in which the period, or the time described in paragraph (2), in respect of any wages is less than one week, the Secretary, under regulations

prescribed by him, may authorize an employer to compute the tax to be deducted and withheld as if the aggregate of the wages paid to the employee during the calendar week were paid for a weekly payroll period.

(4) In determining the amount to be deducted and withheld under this subsection, the wages may, at the election of the employer, be computed to the nearest dollar.

**(c) Wage bracket withholding**

(1) At the election of the employer with respect to any employee, the employer shall deduct and withhold upon the wages paid to such employee a tax (in lieu of the tax required to be deducted and withheld under subsection (a)) determined in accordance with tables prescribed by the Secretary in accordance with paragraph (6).

(2) If wages are paid with respect to a period which is not a payroll period, the amount to be deducted and withheld shall be that applicable in the case of a miscellaneous payroll period containing a number of days (including Sundays and holidays) equal to the number of days in the period with respect to which such wages are paid.

(3) In any case in which wages are paid by an employer without regard to any payroll period or other period, the amount to be deducted and withheld shall be that applicable in the case of a miscellaneous payroll period containing a number of days equal to the

number of days (including Sundays and holidays) which have elapsed since the date of the last payment of such wages by such employer during the calendar year, or the date of commencement of employment with such employer during such year, or January 1 of such year, whichever is the later.

(4) In any case in which the period, or the time described in paragraph (3), in respect of any wages is less than one week, the Secretary, under regulations prescribed by him, may authorize an employer to determine the amount to be deducted and withheld under the tables applicable in the case of a weekly payroll period, in which case the aggregate of the wages paid to the employee during the calendar week shall be considered the weekly wages.

(5) If the wages exceed the highest wage bracket, in determining the amount to be deducted and withheld under this subsection, the wages may, at the election of the employer, be computed to the nearest dollar.

(6) In the case of wages paid after December 31, 1969, the amount deducted and withheld under paragraph (1) shall be determined in accordance with tables prescribed by the Secretary. In the tables so prescribed, the amounts set forth as amounts of wages and amounts of income tax to be deducted and withheld shall be computed on the basis of the table for an annual payroll period prescribed pursuant to subsection (a).

**(d) Tax paid by recipient**

If the employer, in violation of the provisions of this chapter, fails to deduct and withhold the tax under this chapter, and thereafter the tax against which such tax may be credited is paid, the tax so required to be deducted and withheld shall not be collected from the employer; but this subsection shall in no case relieve the employer from liability for any penalties or additions to the tax otherwise applicable in respect of such failure to deduct and withhold.

**(e) Included and excluded wages**

If the remuneration paid by an employer to an employee for services performed during one-half or more of any payroll period of not more than 31 consecutive days constitutes wages, all the remuneration paid by such employer to such employee for such period shall be deemed to be wages; but if the remuneration paid by an employer to an employee for services performed during more than one-half of any such payroll period does not constitute wages, then none of the remuneration paid by such employer to such employee for such period shall be deemed to be wages.

**(f) Withholding exemptions**

**(1) In general**

An employee receiving wages shall on any day be entitled to the following withholding exemptions:

(A) an exemption for himself unless he is an individual described in section 151(d)(2);

(B) if the employee is married, any exemption to which his spouse is entitled, or would be entitled if such spouse were an employee receiving wages, under subparagraph (A) or (D), but only if such spouse does not have in effect a withholding exemption certificate claiming such exemption;

(C) an exemption for each individual with respect to whom, on the basis of facts existing at the beginning of such day, there may reasonably be expected to be allowable an exemption under section 151(c) for the taxable year under subtitle A in respect of which amounts deducted and withheld under this chapter in the calendar year in which such day falls are allowed as a credit;

(D) any allowance to which he is entitled under subsection (m), but only if his spouse does not have in effect a withholding exemption certificate claiming such allowance; and

(E) a standard deduction allowance which shall be an amount equal to one exemption (or more than one exemption if so prescribed by the Secretary) unless (i) he is married (as determined under section 7703) and his spouse is an employee receiving wages subject to withholding or (ii) he has withholding exemption certificates in effect with respect to more than one employer.

For purposes of this title, any standard deduction allowance under subparagraph (E) shall be treated as if it were denominated a withholding exemption.

**(2) Exemption certificates**

**(A) On commencement of employment**

On or before the date of the commencement of employment with an employer, the employee shall furnish the employer with a signed withholding exemption certificate relating to the number of withholding exemptions which he claims, which shall in no event exceed the number to which he is entitled.

**(B) Change of status**

If, on any day during the calendar year, the number of withholding exemptions to which the employee is entitled is less than the number of withholding exemptions claimed by the employee on the withholding exemption certificate then in effect with respect to him, the employee shall within 10 days thereafter furnish the employer with a new withholding exemption certificate relating to the number of withholding exemptions which the employee then claims, which shall in no event exceed the number to which he is entitled on such day. If, on any day during the calendar year, the number of withholding exemptions to which the employee is entitled is greater than the number of withholding exemptions claimed, the employee may furnish the employer with a new withholding exemption certificate relating to the number of withholding exemptions which the employee then claims, which shall in no event exceed the number to which he is entitled on such day.

**(C) Change of status which affects next calendar year**

If on any day during the calendar year the number of withholding exemptions to which the employee will be, or may reasonably be expected to be, entitled at the beginning of his next taxable year under subtitle A is different from the number to which the employee is entitled on such day, the employee shall, in such cases and at such times as the Secretary may by regulations prescribe, furnish the employer with a withholding exemption certificate relating to the number of withholding exemptions which he claims with respect to such next taxable year, which shall in no event exceed the number to which he will be, or may reasonably be expected to be, so entitled.

**(3) When certificate takes effect**

**(A) First certificate furnished**

A withholding exemption certificate furnished the employer in cases in which no previous such certificate is in effect shall take effect as of the beginning of the first payroll period ending, or the first payment of wages made without regard to a payroll period, on or after the date on which such certificate is so furnished.

**(B) Furnished to take place of existing certificate**

**(i) In general**

Except as provided in clauses (ii) and (iii), a withholding exemption certificate furnished to the

employer in cases in which a previous such certificate is in effect shall take effect as of the beginning of the 1st payroll period ending (or the 1st payment of wages made without regard to a payroll period) on or after the 30th day after the day on which such certificate is so furnished.

**(ii) Employer may elect earlier effective date**

At the election of the employer, a certificate described in clause (i) may be made effective beginning with any payment of wages made on or after the day on which the certificate is so furnished and before the 30th day referred to in clause (i).

**(iii) Change of status which affects next year**

Any certificate furnished pursuant to paragraph (2)(C) shall not take effect, and may not be made effective, with respect to any payment of wages made in the calendar year in which the certificate is furnished.

**(4) Period during which certificate remains in effect**

A withholding exemption certificate which takes effect under this subsection, or which on December 31, 1954, was in effect under the corresponding subsection of prior law, shall continue in effect with respect to the employer until another such certificate takes effect under this subsection.

**(5) Form and contents of certificate**

Withholding exemption certificates shall be in such form and contain such information as the Secretary may by regulations prescribe.

**(6) Exemption of certain nonresident aliens**

Notwithstanding the provisions of paragraph (1), a nonresident alien individual (other than an individual described in section 3401(a)(6)(A) or (B)) shall be entitled to only one withholding exemption.

**(7) Exemption where certificate with another employer is in effect**

If a withholding exemption certificate is in effect with respect to one employer, an employee shall not be entitled under a certificate in effect with any other employer to any withholding exemption which he has claimed under such first certificate.

**(g) Overlapping pay periods, and payment by agent or fiduciary**

If a payment of wages is made to an employee by an employer—

(1) with respect to a payroll period or other period, any part of which is included in a payroll period or other period with respect to which wages are also paid to such employee by such employer, or

(2) without regard to any payroll period or other period, but on or prior to the expiration of a payroll period or other period with respect to which wages are also paid to such employee by such employer, or

(3) with respect to a period beginning in one and ending in another calendar year, or

(4) through an agent, fiduciary, or other person who also has the control, receipt, custody, or disposal of, or pays, the wages payable by another employer to such employee,

the manner of withholding and the amount to be deducted and withheld under this chapter shall be determined in accordance with regulations prescribed by the Secretary under which the withholding exemption allowed to the employee in any calendar year shall approximate the withholding exemption allowable with respect to an annual payroll period.

**(h) Alternative methods of computing amount to be withheld**

The Secretary may, under regulations prescribed by him, authorize—

**(1) Withholding on basis of average wages**

An employer—

(A) to estimate the wages which will be paid to any employee in any quarter of the calendar year,

(B) to determine the amount to be deducted and withheld upon each payment of wages to such employee during such quarter as if the appropriate average of the wages so estimated constituted the actual wages paid, and

(C) to deduct and withhold upon any payment of wages to such employee during such quarter (and,

in the case of tips referred to in subsection (k), within 30 days thereafter) such amount as may be necessary to adjust the amount actually deducted and withheld upon the wages of such employee during such quarter to the amount required to be deducted and withheld during such quarter without regard to this subsection.

**(2) Withholding on basis of annualized wages**

An employer to determine the amount of tax to be deducted and withheld upon a payment of wages to an employee for a payroll period by—

(A) multiplying the amount of an employee's wages for a payroll period by the number of such payroll periods in the calendar year,

(B) determining the amount of tax which would be required to be deducted and withheld upon the amount determined under subparagraph (A) if such amount constituted the actual wages for the calendar year and the payroll period of the employee were an annual payroll period, and

(C) dividing the amount of tax determined under subparagraph (B) by the number of payroll periods (described in subparagraph (A)) in the calendar year.

**(3) Withholding on basis of cumulative wages**

An employer, in the case of any employee who requests to have the amount of tax to be withheld from his wages computed on the basis of his cumulative wages, to—

(A) add the amount of the wages to be paid to the employee for the payroll period to the total amount of wages paid by the employer to the employee during the calendar year,

(B) divide the aggregate amount of wages computed under subparagraph (A) by the number of payroll periods to which such aggregate amount of wages relates,

(C) compute the total amount of tax that would have been required to be deducted and withheld under subsection (a) if the average amount of wages (as computed under subparagraph (B)) had been paid to the employee for the number of payroll periods to which the aggregate amount of wages (computed under subparagraph (A)) relates,

(D) determine the excess, if any, of the amount of tax computed under subparagraph (C) over the total amount of tax deducted and withheld by the employer from wages paid to the employee during the calendar year, and

(E) deduct and withhold upon the payment of wages (referred to in subparagraph (A)) to the employee an amount equal to the excess (if any) computed under subparagraph (D).

**(4) Other methods**

An employer to determine the amount of tax to be deducted and withheld upon the wages paid to an employee by any other method which will require

the employer to deduct and withhold upon such wages substantially the same amount as would be required to be deducted and withheld by applying subsection (a) or (c), either with respect to a payroll period or with respect to the entire taxable year.

**(i) Changes in withholding**

**(1) In general**

The Secretary may by regulations provide for increases in the amount of withholding otherwise required under this section in cases where the employee requests such changes.

**(2) Treatment as tax**

Any increased withholding under paragraph (1) shall for all purposes be considered tax required to be deducted and withheld under this chapter.

**(j) Noncash remuneration to retail commission salesman**

In the case of remuneration paid in any medium other than cash for services performed by an individual as a retail salesman for a person, where the service performed by such individual for such person is ordinarily performed for remuneration solely by way of cash commission an employer shall not be required to deduct or withhold any tax under this subchapter with respect to such remuneration, provided that such employer files with the Secretary such information with respect to such remuneration as the Secretary may by regulation prescribe.

**(k) Tips**

In the case of tips which constitute wages, subsection (a) shall be applicable only to such tips as are included in a written statement furnished to the employer pursuant to section 6053(a), and only to the extent that the tax can be deducted and withheld by the employer, at or after the time such statement is so furnished and before the close of the calendar year in which such statement is furnished, from such wages of the employee (excluding tips, but including funds turned over by the employee to the employer for the purpose of such deduction and withholding) as are under the control of the employer; and an employer who is furnished by an employee a written statement of tips (received in a calendar month) pursuant to section 6053(a) to which paragraph (16)(B) of section 3401(a) is applicable may deduct and withhold the tax with respect to such tips from any wages of the employee (excluding tips) under his control, even though at the time such statement is furnished the total amount of the tips included in statements furnished to the employer as having been received by the employee in such calendar month in the course of his employment by such employer is less than $20. Such tax shall not at any time be deducted and withheld in an amount which exceeds the aggregate of such wages and funds (including funds turned over under section 3102(c)(2) or section 3202(c)(2)) minus any tax required by section 3102(a) or section 3202(a) to be collected from such wages and funds.

**(*l*) Determination and disclosure of marital status**

**(1) Determination of status by employer**

For purposes of applying the tables in subsections (a) and (c) to a payment of wages, the employer shall treat the employee as a single person unless there is in effect with respect to such payment of wages a withholding exemption certificate furnished to the employer by the employee after the date of the enactment of this subsection indicating that the employee is married.

**(2) Disclosure of status by employee**

An employee shall be entitled to furnish the employer with a withholding exemption certificate indicating he is married only if, on the day of such furnishing, he is married (determined with the application of the rules in paragraph (3)). An employee whose marital status changes from married to single shall, at such time as the Secretary may by regulations prescribe, furnish the employer with a new withholding exemption certificate.

**(3) Determination of marital status**

For purposes of paragraph (2), an employee shall on any day be considered—

(A) as not married, if (i) he is legally separated from his spouse under a decree of divorce or separate maintenance, or (ii) either he or his spouse is, or on any preceding day within the calendar year was, a nonresident alien; or

(B) as married, if (i) his spouse (other than a spouse referred to in subparagraph (A)) died within the portion of his taxable year which precedes such day, or (ii) his spouse died during one of the two taxable years immediately preceding the current taxable year and, on the basis of facts existing at the beginning of such day, the employee reasonably expects, at the close of his taxable year, to be a surviving spouse (as defined in section 2(a)).

**(m) Withholding allowances**

Under regulations prescribed by the Secretary, an employee shall be entitled to additional withholding allowances or additional reductions in withholding under this subsection. In determining the number of additional withholding allowances or the amount of additional reductions in withholding under this subsection, the employee may take into account (to the extent and in the manner provided by such regulations)—

(1) estimated itemized deductions allowable under chapter 1 (other than the deductions referred to in section 151 and other than the deductions required to be taken into account in determining adjusted gross income under section 62(a) (other than paragraph (10) thereof)),

(2) estimated tax credits allowable under chapter 1, and

(3) such additional deductions (including the additional standard deduction under section 63(c)(3) for the aged and blind) and other items as may be specified by the Secretary in regulations.

**(n) Employees incurring no income tax liability**

Notwithstanding any other provision of this section, an employer shall not be required to deduct and withhold any tax under this chapter upon a payment of wages to an employee if there is in effect with respect to such payment a withholding exemption certificate (in such form and containing such other information as the Secretary may prescribe) furnished to the employer by the employee certifying that the employee—

(1) incurred no liability for income tax imposed under subtitle A for his preceding taxable year, and

(2) anticipates that he will incur no liability for income tax imposed under subtitle A for his current taxable year.

The Secretary shall by regulations provide for the coordination of the provisions of this subsection with the provisions of subsection (f).

**(o) Extension of withholding to certain payments other than wages**

**(1) General rule**

For purposes of this chapter (and so much of subtitle F as relates to this chapter)—

(A) any supplemental unemployment compensation benefit paid to an individual,

(B) any payment of an annuity to an individual, if at the time the payment is made a request that such annuity be subject to withholding under this chapter is in effect, and

(C) any payment to an individual of sick pay which does not constitute wages (determined without regard to this subsection), if at the time the payment is made a request that such sick pay be subject to withholding under this chapter is in effect,

shall be treated as if it were a payment of wages by an employer to an employee for a payroll period.

**(2) Definitions**

**(A) Supplemental unemployment compensation benefits**

For purposes of paragraph (1), the term "supplemental unemployment compensation benefits" means amounts which are paid to an employee, pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment (whether or not such separation is temporary), resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, but only to the extent such benefits are includible in the employee's gross income.

**(B) Annuity**

For purposes of this subsection, the term "annuity" means any amount paid to an individual as a pension or annuity.

**(C) Sick pay**

For purposes of this subsection, the term "sick pay" means any amount which—

(i) is paid to an employee pursuant to a plan to which the employer is a party, and

(ii) constitutes remuneration or a payment in lieu of remuneration for any period during which the employee is temporarily absent from work on account of sickness or personal injuries.

**(3) Amount withheld from annuity payments or sick pay**

If a payee makes a request that an annuity or any sick pay be subject to withholding under this chapter, the amount to be deducted and withheld under this chapter from any payment to which such request applies shall be an amount (not less than a minimum amount determined under regulations prescribed by the Secretary) specified by the payee in such request. The amount deducted and withheld with respect to a payment which is greater or less than a full payment shall bear the same relation to the specified amount as such payment bears to a full payment.

**(4) Request for withholding**

A request that an annuity or any sick pay be subject to withholding under this chapter—

(A) shall be made by the payee in writing to the person making the payments and shall contain the social security number of the payee,

(B) shall specify the amount to be deducted and withheld from each full payment, and

(C) shall take effect—

(i) in the case of sick pay, with respect to payments made more than 7 days after the date on which such request is furnished to the payor, or

(ii) in the case of an annuity, at such time (after the date on which such request is furnished to the payor) as the Secretary shall by regulations prescribe.

Such a request may be changed or terminated by furnishing to the person making the payments a written statement of change or termination which shall take effect in the same manner as provided in subparagraph (C). At the election of the payor, any such request (or statement of change or revocation) may take effect earlier than as provided in subparagraph (C).

**(5) Special rule for sick pay paid pursuant to certain collective-bargaining agreements**

In the case of any sick pay paid pursuant to a collective-bargaining agreement between employee representatives and one or more employers which contains a provision specifying that this paragraph is to apply to sick pay paid pursuant to such agreement and contains a provision for determining the amount to be deducted and withheld from each payment of such sick pay—

(A) the requirement of paragraph (1)(C) that a request for withholding be in effect shall not apply, and

(B) except as provided in subsection (n), the amounts to be deducted and withheld under this chapter shall be determined in accordance with such agreement.

The preceding sentence shall not apply with respect to sick pay paid pursuant to any agreement to any individual unless the social security number of such individual is furnished to the payor and the payor is furnished with such information as is necessary to determine whether the payment is pursuant to the agreement and to determine the amount to be deducted and withheld.

**(6) Coordination with withholding on designated distributions under section 3405**

This subsection shall not apply to any amount which is a designated distribution (within the meaning of section 3405(e)(1)).

**(p) Voluntary withholding agreements**

**(1) Certain Federal payments**

**(A) In general**

If, at the time a specified Federal payment is made to any person, a request by such person is in effect that such payment be subject to withholding under this chapter, then for purposes of this chapter and so much of subtitle F as relates to this chapter, such payment shall be treated as if it were a payment of wages by an employer to an employee.

**(B) Amount withheld**

The amount to be deducted and withheld under this chapter from any payment to which any request under subparagraph (A) applies shall be an amount equal to the percentage of such payment specified in such request. Such a request shall apply to any payment only if the percentage specified is 7 percent, any percentage applicable to any of the 3 lowest income brackets in the table under section 1(c), or such other percentage as is permitted under regulations prescribed by the Secretary.

**(C) Specified Federal payments**

For purposes of this paragraph, the term "specified Federal payment" means—

(i) any payment of a social security benefit (as defined in section 86(d)),

(ii) any payment referred to in the second sentence of section 451(d) which is treated as insurance proceeds,

(iii) any amount which is includible in gross income under section 77(a), and

(iv) any other payment made pursuant to Federal law which is specified by the Secretary for purposes of this paragraph.

**(D) Requests for withholding**

Rules similar to the rules that apply to annuities under subsection (*o*)(4) shall apply to requests under this paragraph and paragraph (2).

**(2) Voluntary withholding on unemployment benefits**

If, at the time a payment of unemployment compensation (as defined in section 85(b)) is made to any person, a request by such person is in effect that such payment be subject to withholding under this chapter, then for purposes of this chapter and so much of subtitle F as relates to this chapter, such payment shall be treated as if it were a payment of wages by an employer to an employee. The amount to be deducted and withheld under this chapter from any payment to which any request under this para-

graph applies shall be an amount equal to 10 percent of such payment.

**(3) Authority for other voluntary withholding**

The Secretary is authorized by regulations to provide for withholding—

(A) from remuneration for services performed by an employee for the employee's employer which (without regard to this paragraph) does not constitute wages, and

(B) from any other type of payment with respect to which the Secretary finds that withholding would be appropriate under the provisions of this chapter,

if the employer and employee, or the person making and the person receiving such other type of payment, agree to such withholding. Such agreement shall be in such form and manner as the Secretary may by regulations prescribe. For purposes of this chapter (and so much of subtitle F as relates to this chapter), remuneration or other payments with respect to which such agreement is made shall be treated as if they were wages paid by an employer to an employee to the extent that such remuneration is paid or other payments are made during the period for which the agreement is in effect.

**(q) Extension of withholding to certain gambling winnings**

**(1) General rule**

Every person, including the Government of the United States, a State, or a political subdivision thereof, or any instrumentalities of the foregoing, making any payment of winnings which are subject to withholding shall deduct and withhold from such payment a tax in an amount equal to the product of the third lowest rate of tax applicable under section 1(c) and such payment.

**(2) Exemption where tax otherwise withheld**

In the case of any payment of winnings which are subject to withholding made to a nonresident alien individual or a foreign corporation, the tax imposed under paragraph (1) shall not apply to any such payment subject to tax under section 1441(a) (relating to withholding on nonresident aliens) or tax under section 1442(a) (relating to withholding on foreign corporations).

**(3) Winnings which are subject to withholding**

For purposes of this subsection, the term "winnings which are subject to withholding" means proceeds from a wager determined in accordance with the following:

**(A) In general**

Except as provided in subparagraphs (B) and (C), proceeds of more than $5,000 from a wagering

transaction, if the amount of such proceeds is at least 300 times as large as the amount wagered.

**(B) State-conducted lotteries**

Proceeds of more than $5,000 from a wager placed in a lottery conducted by an agency of a State acting under authority of State law, but only if such wager is placed with the State agency conducting such lottery, or with its authorized employees or agents.

**(C) Sweepstakes, wagering pools, certain parimutul pools, jai alai, and lotteries**

Proceeds of more than $5,000 from—

(i) a wager placed in a sweepstakes, wagering pool, or lottery (other than a wager described in subparagraph (B)), or

(ii) a wagering transaction in a parimutuel pool with respect to horse races, dog races, or jai alai if the amount of such proceeds is at least 300 times as large as the amount wagered.

**(4) Rules for determining proceeds from a wager**

For purposes of this subsection—

(A) proceeds from a wager shall be determined by reducing the amount received by the amount of the wager, and

(B) proceeds which are not money shall be taken into account at their fair market value.

**(5) Exception for bingo, keno, and slot machines**

The tax imposed under paragraph (1) shall not apply to winnings from a slot machine, keno, and bingo.

**(6) Statement by recipient**

Every person who is to receive a payment of winnings which are subject to withholding shall furnish the person making such payment a statement, made under the penalties of perjury, containing the name, address, and taxpayer identification number of the person receiving the payment and of each person entitled to any portion of such payment.

**(7) Coordination with other sections**

For purposes of sections 3403 and 3404 and for purposes of so much of subtitle F (except section 7205) as relates to this chapter, payments to any person of winnings which are subject to withholding shall be treated as if they were wages paid by an employer to an employee.

**(r) Extension of withholding to certain taxable payments of Indian casino profits**

**(1) In general**

Every person, including an Indian tribe, making a payment to a member of an Indian tribe from the net revenues of any class II or class III gaming activity conducted or licensed by such tribe shall deduct and withhold from such payment a tax in an amount equal to such payment's proportionate share of the annualized tax.

**(2) Exception**

The tax imposed by paragraph (1) shall not apply to any payment to the extent that the payment, when annualized, does not exceed an amount equal to the sum of—

(A) the basic standard deduction (as defined in section 63(c)) for an individual to whom section 63(c)(2)(C)[21] applies, and

(B) the exemption amount (as defined in section 151(d)).

**(3) Annualized tax**

For purposes of paragraph (1), the term "annualized tax" means, with respect to any payment, the amount of tax which would be imposed by section 1(c) (determined without regard to any rate of tax in excess of the fourth lowest rate of tax applicable under section 1(c)) on an amount of taxable income equal to the excess of—

(A) the annualized amount of such payment, over

(B) the amount determined under paragraph (2).

**(4) Classes of gaming activities, etc.**

For purposes of this subsection, terms used in paragraph (1) which are defined in section 4 of the Indian Gaming Regulatory Act (25 U.S.C. 2701 et seq.), as in effect on the date of the enactment of this

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[21] See References in Text note below.

subsection, shall have the respective meanings given such terms by such section.

**(5) Annualization**

Payments shall be placed on an annualized basis under regulations prescribed by the Secretary.

**(6) Alternate withholding procedures**

At the election of an Indian tribe, the tax imposed by this subsection on any payment made by such tribe shall be determined in accordance with such tables or computational procedures as may be specified in regulations prescribed by the Secretary (in lieu of in accordance with paragraphs (2) and (3)).

**(7) Coordination with other sections**

For purposes of this chapter and so much of subtitle F as relates to this chapter, payments to any person which are subject to withholding under this subsection shall be treated as if they were wages paid by an employer to an employee.

**(s) Exemption from withholding for any vehicle fringe benefit**

**(1) Employer election not to withhold**

The employer may elect not to deduct and withhold any tax under this chapter with respect to any vehicle fringe benefit provided to any employee if such employee is notified by the employer of such election (at such time and in such manner as the Secretary shall by regulations prescribe). The preceding sentence shall not apply to any vehicle fringe benefit

unless the amount of such benefit is included by the employer on a statement timely furnished under section 6051.

**(2) Employer must furnish W-2**

Any vehicle fringe benefit shall be treated as wages from which amounts are required to be deducted and withheld under this chapter for purposes of section 6051.

**(3) Vehicle fringe benefit**

For purposes of this subsection, the term "vehicle fringe benefit" means any fringe benefit—

(A) which constitutes wages (as defined in section 3401), and

(B) which consists of providing a highway motor vehicle for the use of the employee.

5. Section 31.3121(a)-1 of Title 26 of the Code of Federal Regulations provides:

**Wages.**

(a)(1) Whether remuneration paid after 1954 for employment performed after 1936 constitutes wages is determined under section 3121(a). This section and §§ 31.3121(a)(1)-1 to 31.3121(a)(15)-1, inclusive (relating to the statutory exclusions from wages), apply with respect only to remuneration paid after 1954 for employment performed after 1936. Whether remuneration paid after 1936 and before 1940 for employment performed after 1936 constitutes wages shall be de-

termined in accordance with the applicable provisions of law and of 26 CFR (1939) Part 401 (Regulations 91). Whether remuneration paid after 1939 and before 1951 for employment performed after 1936 constitutes wages shall be determined in accordance with the applicable provisions of law and of 26 CFR (1939) Part 402 (Regulations 106). Whether remuneration paid after 1950 and before 1955 for employment performed after 1936 constitutes wages shall be determined in accordance with the applicable provisions of law and of 26 CFR (1939) Part 408 (Regulations 128).

(2) The term *compensation* as used in section 3231(e) of the Internal Revenue Code has the same meaning as the term *wages* as used in this section, determined without regard to section 3121(b)(9), except as specifically limited by the Railroad Retirement Tax Act (chapter 22 of the Internal Revenue Code) or regulation. The Commissioner may provide any additional guidance that may be necessary or appropriate in applying the definitions of sections 3121(a) and 3231(e).

(b) The term "wages" means all remuneration for employment unless specifically excepted under section 3121(a) (see §§ 31.3121(a)(1)-1 to 31.3121(a)(15)-1, inclusive) or paragraph (j) of this section.

(c) The name by which the remuneration for employment is designated is immaterial. Thus, salaries, fees, bonuses, and commissions on sales or on insurance premiums, are wages if paid as compensation for employment.

(d) Generally the basis upon which the remuneration is paid is immaterial in determining whether the remuneration constitutes wages. Thus, it may be paid on the basis of piecework, or a percentage of profits; and it may be paid hourly, daily, weekly, monthly, or annually. See, however, § 31.3121(a)(8)-1 which relates to the treatment of cash remuneration computed on a time basis for agricultural labor.

(e) Generally the medium in which the remuneration is paid is also immaterial. It may be paid in cash or in something other than cash, as for example, goods, lodging, food, or clothing. Remuneration paid in items other than cash shall be computed on the basis of the fair value of such items at the time of payment. See, however, §§ 31.3121 (a)(7)-1, 31.3121(a)(8)-1, 31.3121(a)(10)-1, and 31.3121(a)(12)-1, relating to the treatment of remuneration paid in any medium other than cash for services not in the course of the employer's trade or business and for domestic service in a private home of the employer, for agricultural labor, for services performed by certain homeworkers, and as tips, respectively.

(f) Ordinarily, facilities or privileges (such as entertainment, medical services, or so-called "courtesy" discounts on purchases), furnished or offered by an employer to his employees generally, are not considered as remuneration for employment if such facilities or privileges are of relatively small value and are offered or furnished by the employer merely as a means of promoting the health, good will, contentment, or efficiency of his employees. The term "facilities or

privileges", however, does not ordinarily include the value of meals or lodging furnished, for example, to restaurant or hotel employees, or to seamen or other employees aboard vessels, since generally these items constitute an appreciable part of the total remuneration of such employees.

(g) Amounts of so-called "vacation allowances" paid to an employee constitute wages. Thus, the salary of an employee on vacation, paid notwithstanding his absence from work, constitutes wages.

(h) Amounts paid specifically—either as advances or reimbursements—for traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer are not wages. Traveling and other reimbursed expenses must be identified either by making a separate payment or by specifically indicating the separate amounts where both wages and expense allowances are combined in a single payment. For amounts that are received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990, see § 31.3121(a)-3.

(i) Remuneration for employment, unless such remuneration is specifically excepted under section 3121(a) or paragraph (j) of this section, constitutes wages even though at the time paid the relationship of employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them.

*Example.* A is employed by B during the month of January 1955 in employment and is entitled to receive remuneration of $100 for the services performed for B, the employer, during the month. A leaves the employ of B at the close of business on January 31, 1955. On February 15, 1955 (when A is no longer an employee of B), B pays A the remuneration of $100 which was earned for the services performed in January. The $100 is wages and the taxes are payable with respect thereto.

(j) In addition to the exclusions specified in §§ 31.3121(a)(1)-1 to 31.3121(a)(15)-1, inclusive, the following types of payments are excluded from wages:

(1) Remuneration for services which do not constitute employment under section 3121(b) and which are not deemed to be employment under section 3121(c) (see § 31.3121(c)-1).

(2) Remuneration for services which are deemed not to be employment under section 3121(c) (see § 31.3121(c)-1).

(3) Tips or gratuities paid, prior to January 1, 1966, directly to an employee by a customer of an employer, and not accounted for by the employee to the employer. For provisions relating to the treatment of tips received by an employee after December 31, 1965, as wages, see §§ 31.3121(a)(12) and 31.3121(q).

(k) *Split-dollar life insurance arrangements.* Except as otherwise provided under section 3121(v), see

§§ 1.61-22 and 1.7872-15 of this chapter for rules relating to the treatment of split-dollar life insurance arrangements.

6. Section 31.3121(a)(3)-1 of Title 26 of the Code of Federal Regulations provides:

**Retirement payments.**

The term "wages" does not include any payment made by an employer to an employee (including any amount paid by an employer for insurance or annuities, or into a fund, to provide for any such payment) on account of the employee's retirement. Thus, payments made to an employee on account of his retirement are excluded from wages under this exception even though not made under a plan or system.

7. Section 31.3121(a)(13)-1 of Title 26 of the Code of Federal Regulations provides:

**Payments under certain employers' plans after retirement, disability, or death.**

(a) *In general.* The term "wages" does not include the amount of any payment or series of payments made after January 2, 1968, by an employer to, or on behalf of, an employee or any of his dependents under a plan established by the employer which makes provisions for his employees generally (or for his employees generally and their dependents) or for a class or classes of his employees (or for a class or classes of his

employees and their dependents), which is paid or commences to be paid upon or within a reasonable time after the termination of an employee's employment relationship because of the employee's—

(1) Death,

(2) Retirement for disability, or

(3) Retirement after attaining an age specified in the plan established by the employer or in a pension plan of the employer at the age at which a person in the employee's circumstances is eligible for retirement.

A payment or series of payments made under the circumstances described in the preceding sentence is excluded from "wages" even if made pursuant to an incentive compensation plan which also provides for the making of other types of payments. However, any payment or series of payments which would have been paid if the employee's relationship had not been terminated is not excluded from "wages" under this section and section 3121(a)(13). For example, lump-sum payments for unused vacation time or a final paycheck received after retirement are payments which the employee would have received whether or not he retired and therefore are not excluded from "wages" under this section. Further, if any payment is made upon or after termination of employment for any reason other than those set out in subparagraphs (1), (2), and (3) of this paragraph such payment is not excludable from "wages" by this section. For example, if a pension plan provides for retirement upon disability,

completion of 30 years of service, or attainment of age 65, and if an employee who is not disabled retires at age 61 after 30 years of service, none of the retirement payments made to the employee under the pension plan (including any made after he is 65) is excludable from "wages" under this section. However, if the pension plan had conditioned retirement after 30 years of service upon attainment of age 60, all of the retirement payments would have been excludable.

(b) *Plan.* The plan or system established by an employer need not provide for payments because of termination of employment for all the reasons set out in paragraphs (a)(1), (2), and (3) of this section, but such plan or system may provide for payments because of termination for any one or more of such reasons. Payments because of termination of employment for any one or more of such reasons under a plan or system established by an employer solely for the dependents of his employees are not within this exclusion from wages.

(c) *Dependents.* Dependents of an employee include the employee's husband or wife, children, and any other members of the employee's immediate family.

(d) *Benefit payment.* It is immaterial for purposes of this exclusion whether the amount or possibility of benefit payments is paid on account of services rendered or taken into consideration in fixing the amount of an employee's remuneration or whether such payments are required, expressly or impliedly, by the contract of service.

(e) *Example.* The application of this section may be illustrated by the following example:

*Example.* A, an employee, receives a salary of $1,500 a month, payable on the 5th day of the month following the month for which the salary is earned. A's employer has established an incentive compensation plan for a class of his employees, including A, providing for the payment of deferred compensation on termination of employment, including termination upon an employee's death, retirement at age 65 (the retirement age specified in the plan), or retirement for disability. On March 1, 1973, A attains the age of 65 and retires. On March 5, 1973, A receives $5,500 from his employer of which $1,500 represents A's salary for services he performed in February 1973, and $4,000 represents incentive compensation paid under the employer's plan. The amount of $4,000 is excluded from "wages" under this section. The amount of $1,500 is not excluded from "wages" under this section.

8. Section 31.3121(a)(14)-1 of Title 26 of the Code of Federal Regulations provides:

**Payments by employer to survivor or estate of former employee.**

The term "wages" does not include any payment by an employer to a survivor or the estate of a former employee made after 1972 and after the calendar year in which such employee died.

9. Section 31.3121(a)(15)-1 of Title 26 of the Code of Federal Regulations provides:

**Payments by employer to disabled former employee.**

The term "wages" does not include any payment made after 1972 by an employer to an employee, if at the time such payment is made such employee is entitled to disability insurance benefits under section 223(a) of the Social Security Act and such entitlement commenced prior to the calendar year in which such payment is made, and if such employee did not perform any service for such employer during the period for which such payment is made.

10. Section 31.3401(a)-1 of Title 26 of the Code of Federal Regulations provides:

**Wages.**

(a) *In general.* (1) The term "wages" means all remuneration for services performed by an employee for his employer unless specifically excepted under section 3401(a) or excepted under section 3402(e).

(2) The name by which the remuneration for services is designated is immaterial. Thus, salaries, fees, bonuses, commissions on sales or on insurance premiums, pensions, and retired pay are wages within the meaning of the statute if paid as compensation for services performed by the employee for his employer.

(3) The basis upon which the remuneration is paid is immaterial in determining whether the remunera-

tion constitutes wages. Thus, it may be paid on the basis of piecework, or a percentage of profits; and may be paid hourly, daily, weekly, monthly, or annually.

(4) Generally the medium in which remuneration is paid is also immaterial. It may be paid in cash or in something other than cash, as for example, stocks, bonds, or other forms of property. (See, however, § 31.3401(a)(11)-1, relating to the exclusion from wages of remuneration paid in any medium other than cash for services not in the course of the employer's trade or business, and § 31.3401(a)(16)-1, relating to the exclusion from wages of tips paid in any medium other than cash.) If services are paid for in a medium other than cash, the fair market value of the thing taken in payment is the amount to be included as wages. If the services were rendered at a stipulated price, in the absence of evidence to the contrary, such price will be presumed to be the fair value of the remuneration received. If a corporation transfers to its employees its own stock as remuneration for services rendered by the employee, the amount of such remuneration is the fair market value of the stock at the time of the transfer.

(5) Remuneration for services, unless such remuneration is specifically excepted by the statute, constitutes wages even though at the time paid the relationship of employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them.

*Example.* A is employed by R during the month of January 1955 and is entitled to receive remuneration of $100 for the services performed for R, the employer, during the month. A leaves the employ of R at the close of business on January 31, 1955. On February 15, 1955 (when A is no longer an employee of R), R pays A the remuneration of $100 which was earned for the services performed in January. The $100 is wages within the meaning of the statute.

(b) *Certain specific items—(1) Pensions and retirement pay.* (i) In general, pensions and retired pay are wages subject to withholding. However, no withholding is required with respect to amounts paid to an employee upon retirement which are taxable as annuities under the provisions of section 72 or 403. So-called pensions awarded by one to whom no services have been rendered are mere gifts or gratuities and do not constitute wages. Those payments of pensions or other benefits by the Federal Government under Title 38 of the United States Code which are excluded from gross income are not wages subject to withholding.

(ii) Amounts received as retirement pay for service in the Armed Forces of the United States, the Coast and Geodetic Survey, or the Public Health Service or as a disability annuity paid under the provisions of section 831 of the Foreign Service Act of 1946, as amended (22) U.S.C. 1081; 60 Stat. 1021), are subject to withholding unless such pay or disability annuity is excluded from gross income under section 104(a)(4), or is taxable as an annuity under the provisions of section

72. Where such retirement pay or disability annuity (not excluded from gross income under section 104(a)(4) and not taxable as an annuity under the provisions of section 72) is paid to a nonresident alien individual, withholding is required only in the case of such amounts paid to a nonresident alien individual who is a resident of Puerto Rico.

(2) *Traveling and other expenses.* Amounts paid specifically—either as advances or reimbursements—for traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer are not wages and are not subject to withholding. Traveling and other reimbursed expenses must be identified either by making a separate payment or by specifically indicating the separate amounts where both wages and expense allowances are combined in a single payment. For amounts that are received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990, see § 31.3401 (a)-4.

(3) *Vacation allowances.* Amounts of so-called "vacation allowances" paid to an employee constitute wages. Thus, the salary of an employee on vacation, paid notwithstanding his absence from work, constitutes wages.

(4) *Dismissal payments.* Any payments made by an employer to an employee on account of dismissal, that is, involuntary separation from the service of the employer, constitute wages regardless of whether

the employer is legally bound by contract, statute, or otherwise to make such payments.

(5) *Deductions by employer from remuneration of an employee.* Any amount deducted by an employer from the remuneration of an employee is considered to be a part of the employee's remuneration and is considered to be paid to the employee as remuneration at the time that the deduction is made. It is immaterial that any act of Congress, or the law of any State or of Puerto Rico, requires or permits such deductions and the payment of the amounts thereof to the United States, a State, a Territory, Puerto Rico, or the District of Columbia, or any political subdivision of any one or more of the foregoing.

(6) *Payment by an employer of employee's tax, or employee's contributions under a State law.* The term "wages" includes the amount paid by an employer on behalf of an employee (without deduction from the remuneration of, or other reimbursement from, the employee) on account of any payment required from an employee under a State unemployment compensation law, or on account of any tax imposed upon the employee by any taxing authority, including the taxes imposed by sections 3101 and 3201.

(7) *Remuneration for services as employee of nonresident alien individual or foreign entity.* The term "wages" includes remuneration for services performed by a citizen or resident (including, in regard to wages paid after February 28, 1979, an individual treated as a resident under section 6013 (g) or

(h)) of the United States as an employee of a nonresident alien individual, foreign partnership, or foreign corporation whether or not such alien individual or foreign entity is engaged in trade or business within the United States. Any person paying wages on behalf of a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States (including Puerto Rico as if a part of the United States), is subject to all the provisions of law and regulations applicable with respect to an employer. See § 31.3401(d)-1, relating to the term "employer", and § 31.3401(a)(8)(C)-1, relating to remuneration paid for services performed by a citizen of the United States in Puerto Rico.

(8) *Amounts paid under accident or health plans* —(i) *Amounts paid in taxable years beginning on or after January 1, 1977*—(a) *In general.* Withholding is required on all payments of amounts includible in gross income under section 105(a) and § 1.105-1 (relating to amounts attributable to employer contributions), made in taxable years beginning on or after January 1, 1977, to an employee under an accident or health plan for a period of absence from work on account of personal injuries or sickness. Payments on which withholding is required by this subdivision are wages as defined in section 3401(a), and the employer shall deduct and withhold in accordance with the requirements of chapter 24 of subtitle C of the Code. Third party payments of sick pay, as defined in section 3402(o) and the regulations thereunder, are not wages for purposes of this section.

(*b*) *Payments made by an agent of the employer.* (*1*) Payments are considered made by the employer if a third party makes the payments as an agent of the employer. The determining factor as to whether a third party is an agent of the employer is whether the third party bears any insurance risk. If the third party bears no insurance risk and is reimbursed on a cost plus fee basis, the third party is an agent of the employer even if the third party is responsible for making determinations of the eligibility of individual employees of the employer for sick pay payments. If the third party is paid an insurance premium and not reimbursed on a cost plus fee basis, the third party is not an agent of the employer, but the third party is a payor of third party sick pay for purposes of voluntary withholding from sick pay under sections 3402(o) and 6051(f) and the regulations thereunder. If a third party and an employer enter into an agency agreement as provided in paragraph (c) of § 31.6051-3 (relating to statements required in case of sick pay paid by third parties), that agency agreement does not make the third party an agent of the employer for purposes of this paragraph.

(*2*) Payments made by agents subject to this paragraph are supplemental wages as defined in § 31.3402(g)-1, and are therefore subject to the rules regarding withholding tax on supplemental wages provided in § 31.3402(g)-1. For purposes of those rules, unless the agent is also an agent for purposes of withholding tax from the employee's regular wages, the agent may deem tax to have been withheld

from regular wages paid to the employee during the calendar year.

(*3*) This paragraph is only applicable to amounts paid on or after May 25, 1983 unless the agent actually withheld taxes before that date.

(*c*) *Exceptions to withholding.* (*1*) Withholding is not required on payments that are specifically excepted under the numbered paragraphs of section 3401(a) (relating to the definition of wages), under section 3402(e) (relating to included and excluded wages), or under section 3402(n) (relating to employees incurring no income tax liability).

(*2*) Withholding is not required on disability payments to the extent that the payments are excludable from gross income under section 105(d). In determining the excludable portion of the disability payments, the employer may assume that payments that the employer makes to the employee are the employee's sole source of income. This exception applies only if the employee furnishes the employer with adequate verification of disability. A certificate from a qualified physician attesting that the employee is permanently and totally disabled (within the meaning of section 105(d)) shall be deemed to constitute adequate verification. This exception does not affect the requirement that a statement (which includes any amount paid under section 105(d)) be furnished under either section 6041 (relating to information at source) or section 6051 (relating to

receipts for employees) and the regulations thereunder.

(ii) *Amounts paid after December 31, 1955 and before January 1, 1977—(a) In general.* The term "wage continuation payment", as used in this subdivision, means any payment to an employee which is made after December 31, 1955, and before January 1, 1977 under a wage continuation plan (as defined in paragraph (a)(2)(i) of § 1.105-4 and § 1.105-5 of Part 1 of this chapter (Income Tax Regulations)) for a period of absence from work on account of personal injuries or sickness, to the extent such payment is attributable to contributions made by the employer which were not includable in the employee's gross income or is paid by the employer. Any such payment, whether or not excluded from the gross income of the employee under section 105(d), constitutes "wages" (unless specifically excepted under any of the numbered paragraphs of section 3401(a) or under section 3402(e) and withholding thereon is required except as provided in paragraphs (b)(8)(ii) (*b*), (*c*), and (*d*) of this section.

(*b*) *Amounts paid before January 1, 1977, by employer for whom services are performed for period of absence beginning after December 31, 1963.* (*1*) Withholding is not required upon the amount of any wage continuation payment for a period of absence beginning after December 31, 1963, paid before January 1, 1977, to an employee directly by the employer for whom he performs

services to the extent that such payment is excludable from the gross income of the employee under the provisions of section 105(d) in effect with respect to such payments, provided the records maintained by the employer—

(*i*) Separately show the amount of each such payment and the excludable portion thereof, and

(*ii*) Contain data substantiating the employee's entitlement to the exclusion provided in section 105(d) with respect to such amount, either by a written statement from the employee specifying whether his absence from work during the period for which the payment was made was due to a personal injury or to sickness and whether he was hospitalized for at least one day during this period; or by any other information which the employer reasonably believes establishes the employee's entitlement to the exclusion under section 105(d). Employers shall not be required to ascertain the accuracy of any written statement submitted by an employee in accordance with this subdivision *(b)(1)(ii)*.

For purposes of this subdivision *(b)(1)*, wage continuation payments reasonably expected by the employer to be made on behalf of the employer by another person shall be taken into account in determining whether the 75 percent test contained in section 105(d) is met and in computing the amount of any wage continua-

tion payment made directly by the employer for whom services are performed by the employee which is within the $75 or $100 weekly rate of exclusion from the gross income of the employee provided in section 105(d). In making this latter computation, the amount excludable under section 105(d) shall be applied first against payments reasonably expected to be made on behalf of the employer by the other person and then, to the extent any part of the exclusion remains, against the payments made directly by the employer. In a case in which wage continuation payments are not paid at a constant rate for the first 30 calendar days of the period of absence, the determination of whether the 75 percent test contained in section 105(d) is met shall be based upon the length of the employee's absence as of the end of the period for which the payment by the employer is made, without regard to the effect which any further extension of such absence may have upon the excludability of the payment.

(*2*) The computation of the amount of any wage continuation payment with repect to which the employer may refrain from withholding may be illustrated by the following examples:

*Example 1.* A, an employee of B, normally works Monday through Friday and has a regular weekly rate of wages of $100. On Monday, November 5, 1974, A becomes ill, and as a result

is absent from work for two weeks, returing to work on Monday, November 19, 1974. A is not hospitalized. Under B's noncontributory wage continuation plan, A receives no benefits for the first three working days of absence and is paid benefits directly by B at the rate of $85 a week thereafter ($34 for the last two days of the first week of absence and $85 for the second week of absence). No wage continuation payment is made by any other person. Since the benefits are entirely attributable to contributions to the plan by B, such benefits are wage continuation payments in their entirety. The wage continuation payments for the first seven calendar days of absence are not excludable from A's gross income because A was not hospitalized for at least one day during his period of absence, and therefore B must withhold with respect to such payments. Under section 105(a), the wage continuation payments attributable to absence after the first seven calendar days of absence are excludable to the extent that they do not exceed a rate of $75 a week. Under the principles stated in paragraph (e)(6)(iv) of § 1.105-4 of this chapter (Income Tax Regulations), the wage continuation payments in this case are at a rate not in excess of 75 percent (119/200 or 59.5 percent) of A's regular weekly rate of wages. Accordingly, B may refrain from withholding with respect to $75 of the wage continuation payment attributable to the second week of absence.

*Example 2.* Assume the facts in example 1 except that A is unable to return to work until Monday, February 11, 1975, and that, of the $85 a week of wage continuation payments $35 is paid directly by B and $50 is reasonably expected by B to be paid by C, an insurance company, on behalf of B. In such a case, both the $50 and the $35 payments constitute wage continuation payments and the amount of such payments which is attributable to the first 30 calendar days of absence is at a rate not in excess of 75 percent (323/440 or 73.4 percent) of A's regular weekly rate of wages. Therefore, under section 105(d), the portion of such payments which is attributable to absence after the first seven calendar days of absence is excludable to the extent that it does not exceed a rate of $75 a week for the eighth through the thirtieth calendar day of absence and does not exceed a rate of $100 a week thereafter. B may refrain from withholding with repect to $25 a week (the amount by which the $75 maximum excludable amount exceeds the $50 reasonably expected by B to be paid by C) of his direct payments for the eighth through the thirtieth calendar day of absence. Thereafter, B may refrain from withholding with respect to the entire $35 paid directly by him since the maximum excludable amount ($100 a week) exceeds the total of payments made by B and payments which B reasonably expects will be made by C.

(c) *Amounts paid by employer for whom services are performed for period of absence beginning before January 1, 1964.* Withholding is not required upon the amount of any wage continuation payment for a period of absence beginning before January 1, 1964, made to an employee directly by the employer for whom he performs services to the extent that such payment is excludable from the gross income of the employee under the provisions of section 105(d) in effect with respect to such payments, provided the records maintained by the employer—

(*1*) Separately show the amount of each such payment and the excludable portion thereof, and

(*2*) Contain data substantiating the employee's entitlement to the exclusion provided in section 105(d) with respect to such amount, either by a written statement from the employee specifying whether his absence from work during the period for which the payment was made was due to a personal injury or whether such absence was due to sickness, and, if the latter, whether he was hospitalized for at least one day during this period; or by any other information which the employer reasonably believes establishes the employee's entitlement to the exclusion under section 105(d). Employers shall not be required to ascertain the accuracy of the information contained in any written statement submitted by an employee in accordance with

this paragraph (b)(8)(ii)(*c*)(*2*). For purposes of this paragraph (b)(8)(ii)(*c*), the computation of the amount excludable form the gross income of the employee under section 105(d) may be made either on the basis of the wage continuation payments which are made directly by the employer for whom the employee performs services, or on the basis of such payments in conjunction with any wage continuation payments made on behalf of the employer by a person who is regarded as an employer under section 3401(d)(1).

(*d*) *Amounts paid before January 1, 1977 by person other than the employer for whom services are performed.* No tax shall be withheld upon any wage continuation payment made to an employee by or on behalf of a person who is not the employer for whom the employee performs services but who is regarded as an employer under section 3401(d)(1). For example, no tax shall be withheld with respect to wage continuation payments made on behalf of an employer by an insurance company under an accident or health policy, by a separate trust under an accident or health plan, or by a State agency from a sickness and disability fund maintained under State law.

(*e*) *Cross references.* See sections 6001 and 6051 and the regulations thereunder for rules with respect to the records which must be maintained in connection with wage continuation payments and for rules with respect to the state-

ments which must be furnished an employee in connection with wage continuation payments, respectively. See also section 105 and § 1.105-4 of this chapter (Income Tax Regulations).

(9) *Value of meals and lodging.* The value of any meals or lodging furnished to an employee by his employer is not subject to withholding if the value of the meals or lodging is excludable from the gross income of the employee. See § 1.119-1 of this chapter (Income Tax Regulations).

(10) *Facilities or privileges.* Ordinarily, facilities or privileges (such as entertainment, medical services, or so-called "courtesy" discounts on purchases), furnished or offered by an employer to his employees generally, are not considered as wages subject to withholding if such facilities or privileges are of relatively small value and are offered or furnished by the employer merely as a means of promoting the health, good will, contentment, or efficiency of his employees.

(11) *Tips or gratuities.* Tips or gratuities paid, prior to January 1, 1966, directly to an employee by a customer of an employer, and not accounted for by the employee to the employer are not subject to withholding. For provisions relating to the treatment of tips received by an employee after December 31, 1965, as wages, see §§ 31.3401(f)-1 and 31.3402(k)-1.

(12) *Remuneration for services performed by permanent resident of Virgin Islands*—(i) *Exemption from withholding.* No tax shall be withheld for

the United States under chapter 24 from a payment of wages by an employer, including the United States or any agency thereof, to an employee if at the time of payment it is reasonable to believe that the employee will be required to satisfy his income tax obligations with respect to such wages under section 28(a) of the Revised Organic Act of the Virgin Islands (68 Stat. 508). That section provides that all persons whose permanent residence is in the Virgin Islands "shall satisfy their income tax obligations under applicable taxing statutes of the United States by paying their tax on income derived from all sources both within and outside the Virgin Islands into the treasury of the Virgin Islands".

(ii) *Claiming exemption.* If the employee furnishes to the employer a statement in duplicate that he expects to satisfy his income tax obligations under section 28(a) of the Revised Organic Act of the Virgin Islands with respect to all wages subsequently to be paid to him by the employer during the taxable year to which the statement relates, the employer may, in the absence of information to the contrary, rely on such statement as establishing reasonable belief that the employee will so satisfy his income tax obligations. The employee's statement shall identify the taxable year to which it relates, and both the original and the duplicate copy thereof shall be signed and dated by the employee.

(iii) *Disposition of statement.* The original of the statement shall be retained by the employer.

The duplicate copy of the statement shall be sent by the employer to the Director of International Operations, Washington, D.C. 20225, on or before the last day of the calendar year in which the employer receives the statement from the employee.

(iv) *Applicability of subparagraph.* This subparagraph has no application with respect to any payment of remuneration which is not subject to withholding by reason of any other provision of the regulations in this subpart.

(13) *Federal employees resident in Puerto Rico.* Except as provided in paragraph (d) of § 31.3401(a)(6)-1, the term "wages" includes remuneration for services performed by a nonresident alien individual who is a resident of Puerto Rico if such services are performed as an employee of the United States or any agency thereof. The place where the services are performed is immaterial for purposes of this subparagraph.

(14) *Supplemental unemployment compensation benefits.* (i) Supplemental unemployment compensation benefits paid to an individual after December 31, 1970, shall be treated (for purposes of the provisions of Subparts E, F, and G of this part which relate to withholding of income tax) as if they were wages, to the extent such benefits are includible in the gross income of such individual.

(ii) For purposes of this subparagraph, the term "supplemental unemployment compensation benefits" means amounts which are paid to an employee, pursuant to a plan to which the employer is a party,

because of the employee's involuntary separation from the employment of the employer, whether or not such separation is temporary, but only when such separation is one resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions.

(iii) For the meanings of the terms "involuntary separation from the employment of the employer" and "other similar conditions", see subparagraphs (3) and (4) of § 1.501(c)(17)-1(b) of this chapter (Income Tax Regulations).

(iv) As used in this subparagraph, the term "employee" means an employee within the meaning of paragraph (a) of § 31.3401(c)-1, the term "employer" means an employer within the meaning of paragraph (a) of § 31.3401(d)-1, and the term "employment" means employment as defined under the usual common law rules.

(v) References in this chapter to wages as defined in section 3401(a) shall be deemed to refer also to supplemental unemployment compensation benefits which are treated under this subparagraph as if they were wages.

(15) *Split-dollar life insurance arrangements.* See § 1.61-22 of this chapter for rules relating to the treatment of split-dollar life insurance arrangements.

(c) *Geographical definitions.* For definition of the term "United States" and for other geographical definitions relating to the Continental Shelf see section 638 and § 1.638-1 of this chapter.

# OPPOSITION BRIEF

RECORD
AND
BRIEFS

No. 12-1408

FILED
JUL 3 0 2013

In The
# Supreme Court of the United States

UNITED STATES OF AMERICA,

*Petitioner,*

v.

QUALITY STORES, INC., ET AL.,

*Respondents.*

**On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit**

## BRIEF IN OPPOSITION

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## QUESTION PRESENTED

Whether "supplemental unemployment compensation benefits," which Congress has defined as amounts "paid to an employee, pursuant to a plan to which the employer is a party, because of the employee's involuntary separation from employment . . . resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions," 26 U.S.C. § 3402(o), constitute wages for purposes of the *Federal Insurance Contributions Act, 26 U.S.C. §§ 3101-3128.*

## PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

Petitioner is the United States of America.

Respondents are QSI Holdings, Inc. (f/k/a CT Holdings, Inc.); Quality Stores, Inc. (f/k/a Central Tractor Farm & Country, Inc.); Country General, Inc.; F and C Holding, Inc.; FarmandCountry.com, LLC; QSI Newco, Inc.; QSI Transportation, Inc.; Quality Farm & Fleet, Inc.; Quality Investments, Inc.; Quality Stores Services, Inc.; and Vision Transportation, Inc.

Respondents, through Rivershore Advisors, LLC, the Chief Litigation Officer appointed pursuant to the confirmed Chapter 11 plan of reorganization, serve as representatives of creditors of post-confirmation bankruptcy estates, some of which may be publicly-traded companies. None of Respondents is a subsidiary or affiliate of a publicly-traded corporation.

TABLE OF CONTENTS


| | Page |
|---|---|
| OPINIONS BELOW | 1 |
| JURISDICTION | 1 |
| STATUTORY AND REGULATORY PROVISIONS INVOLVED | 1 |
| STATEMENT | 2 |
| REASONS FOR DENYING THE PETITION FOR WRIT OF CERTIORARI | 4 |
| I. The Decision Of The Court of Appeals Is Correct | 4 |
| II. There Is No Conflict That Warrants This Court's Review | 13 |
| CONCLUSION | 21 |

## TABLE OF AUTHORITIES

Page

CASES

*Abrahamsen v. United States*, 228 F.3d 1360 (Fed. Cir. 2000), *cert. denied*, 532 U.S. 957 (2001) ..... 14, 15

*Alliant Techsystems, Inc. v. United States of America*, Case No. 0:12-cv-00807-SRN-FLN (U.S.D.C. Minn.) ..... 17

*Anderson v. United States*, 929 F.2d 648 (Fed. Cir. 1991) ..... 11

*Appoloni v. United States*, 450 F.3d 185 (6th Cir. 2006) ..... 14

*Citigroup, Inc. v. United States of America*, Case No. 3:12-cv-00591-JCH (U.S.D.C. Conn.) ..... 17

*Coffy v. Republic Steel Corp.*, 447 U.S. 191 (1980) ..... 4, 6, 15

*CSX Corp., Inc. v. U.S.*, 52 Fed. Cl. 208 (Fed. Cl. 2002), *affirmed in part, reversed in part, CSX Corp. v. U.S.*, 518 F.3d 1328 (Fed. Cir. 2008) ..... 8, 9

*CSX Corp. v. U.S.*, 518 F.3d 1328 (Fed. Cir. 2008) ..... *passim*

*Hemelt v. United States*, 122 F.3d 204 (4th Cir. 1997) ..... 14

*INS v. National Ctr. for Immigrants' Rights, Inc.*, 502 U.S. 183 (1991) ..... 9

TABLE OF AUTHORITIES – Continued

Page

*Kimberly-Clark Corporation v. United States of America*, Case No. 3:12-cv-01168-L (U.S.D.C. N. Tex.) ..... 17

*Kmart Corp. v. Cartier, Inc.*, 486 U.S. 281 (1988) ..... 9

*North Dakota State Univ. v. United States*, 255 F.3d 599 (8th Cir. 2001) ..... 14

*NYSA-ILA Container Royalty Fund v. Commissioner*, 847 F.2d 50 (2d Cir. 1988) ..... 11, 15

*Otte v. United States*, 419 U.S. 43 (1974) ..... 16

*Quality Stores, Inc. v. United States (In re Quality Stores, Inc.)*, 383 B.R. 67 (Bankr. W.D. Mich. 2008) ..... 1

*Rivera v. Baker West, Inc.*, 430 F.3d 1253 (9th Cir. 2005) ..... 14

*Rowan Cos. v. United States*, 452 U.S. 247 (1981) ..... 4, 5, 10

*Soc. Sec. Bd. v. Nierotko*, 327 U.S. 358 (1946) ..... 15, 16

*Stern v. Marshall*, 131 S.Ct. 2594 (2011) ..... 16

*United States v. Bond*, 486 B.R. 9 (E.D.N.Y. 2012) ..... 16

*United States v. Cleveland Indians Baseball Co.*, 532 U.S. 200 (2001) ..... 13, 21

*United States v. Quality Stores, Inc. (In re Quality Stores, Inc.)*, 424 B.R. 237 (W.D. Mich. 2010) ..... 1

TABLE OF AUTHORITIES – Continued

Page

*United States v. Quality Stores, Inc. (In re Quality Stores, Inc.)*, 693 F.3d 605 (6th Cir. 2012) ..... 1

*United States v. Silk*, 331 U.S. 704 (1947) ..... 6

*University of Pittsburgh v. United States*, 507 F.3d 165 (3d Cir. 2007) ..... 14

STATUTES

26 U.S.C. § 501(c)(17) ..... 7, 11, 12

26 U.S.C. § 3121(a) ..... 4, 5, 6, 11, 12

26 U.S.C. § 3121(a)(5)(B) ..... 9

26 U.S.C. § 3121(b) ..... 5

26 U.S.C. § 3301-3311 ..... 18, 19

26 U.S.C. § 3304(a)(11) ..... 11

26 U.S.C. § 3306(b) ..... 12

26 U.S.C. § 3401-3406 .....

26 U.S.C. § 3401(a) ..... 5, 6, 7

26 U.S.C. § 3401(a)(12)(B) ..... 9

26 U.S.C. § 3401(o) ..... 4, 5

26 U.S.C. § 3402(o) ..... *passim*

26 U.S.C. § 3402(o)(1) ..... 8, 9

26 U.S.C. § 3402(o)(1)(A) ..... 8, 9

26 U.S.C. § 3402(o)(1)(B) ..... 8, 9

26 U.S.C. § 3402(o)(1)(C) ..... 9

TABLE OF AUTHORITIES – Continued

Page

26 U.S.C. § 3402(o)(2) ..... 7

26 U.S.C. § 3402(o)(2)(A) ..... 7, 15

26 U.S.C. § 6041 ..... 12

28 U.S.C. § 1254(1) ..... 1

28 U.S.C. § 1295(a)(3) ..... 17

28 U.S.C. § 1346(a) ..... 17

*Federal Insurance Contributions Act, 26 U.S.C. §§ 3101-3128* ..... *passim*

*Federal-State Extended Unemployment Compensation Act of 1970, § 202(a)(3)(D), Pub. L. No. 91-373, 84 Stat. 695 (1970), as amended by P.L. 96-499, 94 Stat. 2659 (1980)* ..... 11

*Social Security Amendments of 1983, Pub. L. No. 98-21, § 327(b)(1), 97 Stat. 65, 127 (1983) (codified in last para. of 26 U.S.C. § 3121(a))* ..... 10, 11, 12

OTHER AUTHORITIES

Employer's Quarterly Tax Return, I.R.S. Form 941 (1971) ..... 19

Quarterly Return of Withheld Federal Income Tax, I.R.S. Form 941E (1971) ..... 19

Miscellaneous Income, I.R.S. Form 1099-MISC (1971) ..... 18, 19, 20

Wage and Tax Statement, I.R.S. Form W-2 (1971) ..... 18, 19

TABLE OF AUTHORITIES – Continued

Page

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Rev. Rul. 77-347, 1977-2 C.B. 362 ..... 12

Rev. Rul. 80-124, 1980-1 C.B. 212 ..... 12

S.Ct. Rule 10 ..... 4

S. Rep. No. 91-552, at 268 (1969) ..... 9

S. Rep. No. 96-1033, at 11 (1980) ..... 8

T.D. 6972, 1968-2 C.B. 222; 33 Fed. Reg. 12899 (September 12, 1968) ..... 18

T.D. 7068, 1970-2 C.B. 252; 35 Fed. Reg. 17328 (November 11, 1970) ..... 20

Treas. Reg. § 1.501(c)(17)-2(j) ..... 2, 18, 19, 20

Treas. Reg. § 1.6041-2(b) ..... 18, 19

Treas. Reg. § 31.3401(a)-1(b)(4) ..... 10

Treas. Reg. § 31.3401(a)-1(b)(14) ..... 10

## OPINIONS BELOW

The opinion of the United States Court of Appeals for the Sixth Circuit (Pet. App. 1a-30a) is reported at 693 F.3d 605. The opinion of the United States District Court for the Western District of Michigan (Pet. App. 33a-54a) is reported at 424 B.R. 237. The opinion of the United States Bankruptcy Court for the Western District of Michigan (Pet. App. 55a-77a) is reported at 383 B.R. 67.

## JURISDICTION

The judgment of the court of appeals was entered on September 7, 2012. A petition for rehearing and rehearing en banc was denied on January 4, 2013. Pet. App. 31a-32a. On March 25, 2013, the Chief Justice extended the time within which to file a petition for a writ of certiorari to and including May 3, 2013. On April 22, 2013, the Chief Justice further extended the time within which to file a petition for a writ of certiorari to and including May 31, 2013. The jurisdiction of this Court was invoked under 28 U.S.C. § 1254(1).

## STATUTORY AND REGULATORY PROVISIONS INVOLVED

Relevant statutory and regulatory provisions are the statutes and regulations reproduced in Pet. App.

84a-214a and Treas. Reg. § 1.501(c)(17)-2(j) and Treas. Reg. § 1.6041-2(b).

## STATEMENT

1. The facts in this case are set forth in the opinion of the court of appeals. Pet. App. 2a-6a, 7a, 11a. Quality Stores, an agricultural specialty retailer, closed all of its stores and distribution centers, terminated the employment of all its employees, and made payments to employees whose employment was involuntarily terminated. Pet. App. 2a-3a. Payments to involuntarily terminated employees were not attributable to the rendering of any particular services by the employees to Respondents. Pet. 5 n.1; Pet. App. 3a, 4a. About 900 terminated employees did not receive any payments because they were hired immediately by successor companies. *Id.* at 4a.

2. Respondents collected and paid taxes under the *Federal Insurance Contributions Act, 26 U.S.C. §§ 3101-3128 ("FICA")*, on the payments, but they did not agree with the Internal Revenue Service that the payments constituted wages for FICA purposes. Respondents took the position that the payments were not wages but instead constituted supplemental unemployment compensation benefit ("SUB") payments that are not taxable under FICA. Pet. App. 5a. Accordingly, Respondents filed claims for refund of the FICA taxes.

After the Internal Revenue Service failed to act on the claims for refund, Respondents filed a proceeding against the United States (the "Government") in the bankruptcy court seeking to recover the overpaid employer and employee FICA taxes plus interest. Pet. App. 37a.

The bankruptcy court held that Respondents and their employees were not liable for FICA taxes and were entitled to a refund of the FICA taxes previously paid. Pet. App. 55a-77a. The Government moved for reconsideration. Pet. App. 78a. The bankruptcy court granted the Government's motion for reconsideration, but ratified its prior decision. Pet. App. 78a-80a.

After the parties filed a stipulation regarding the amount of the FICA tax refund to be paid, the bankruptcy court entered a final judgment in favor of Respondents and their employees in the amount of $1,000,125 plus interest as provided by law. Pet App. 81a-83a. The Government appealed, and the district court affirmed the judgment of the bankruptcy court. Pet. App. 33a-54a.

3. The Government appealed again, and the court of appeals unanimously affirmed the decision of the district court. Pet. App. 1a-30a. The Government filed a petition for rehearing en banc, which the court of appeals denied on January 4, 2013. Pet. App. 31a-32a.

On March 25, 2013, the Chief Justice granted the Government's application to extend the time within which to file a petition for a writ of certiorari to and

including May 3, 2013. On April 22, 2013, the Chief Justice granted the Government's application to further extend the time within which to file a petition for a writ of certiorari to and including May 31, 2013. On May 31, 2013, the Government filed the Petition.

## REASONS FOR DENYING THE PETITION FOR WRIT OF CERTIORARI

### I. The Decision Of The Court of Appeals Is Correct.

The Government argues that the petition should be granted because the court of appeals' decision is incorrect. *See* Pet. 9-20. Ordinarily, that is not a sufficient reason to grant a petition for certiorari. *See* S.Ct. Rule 10. But even if it was, the court of appeals reached the correct result in this case.

A. FICA taxes "wages," which is defined as "all remuneration" for "any service performed by an employee for the person employing him." 26 U.S.C. § 3121(a). SUB payments are not made for "employment" but rather for the "elimination of employment" due to plant shutdowns and similar conditions. Therefore, SUB payments are not wages. This Court's decision in *Coffy v. Republic Steel Corp.*, 447 U.S. 191 (1980), as well as § 3401(o) of the Internal Revenue Code (the "IRC") and its legislative history, confirm this. Moreover, in *Rowan Cos. v. United States*, 452 U.S. 247 (1981), this Court recognized that the definitions of "wages" under Chapter 21 (FICA taxation)

and Chapter 24 (income tax withholding) of the IRC are "substantially identical" and must be construed *in pari materia*. Accordingly, § 3401(o) of the IRC, under which SUB payments are not wages (although they are *treated as wages*) for purposes of income tax withholding, must be taken into account in construing the meaning of wages for purposes of FICA. The court of appeals correctly concluded, therefore, that SUB payments are not wages for purposes of FICA taxation.

In *Rowan*, this Court noted that the term "wages" is defined "substantially identically" under Chapter 21 (FICA taxation) and Chapter 24 (income tax withholding) of the IRC. For FICA tax purposes, § 3121(a) defines "wages" as "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash." 26 U.S.C. § 3121(a). *See* Pet. App. 85a-94a. The term "employment" is defined as "any service performed by an employee for the person employing him." 26 U.S.C. § 3121(b). *See* Pet. App. 95a-112a. Therefore, reading the sections together, "wages" for FICA tax purposes means "all remuneration" for "any service performed by an employee for the person employing him." For federal income tax withholding purposes, the term "wages" is defined in virtually identical terms by § 3401(a) as "all remuneration for services performed by an employee for his employer, including the cash value of all remuneration (including benefits paid) in any medium other than cash." 26 U.S.C. § 3401(a). *See* Pet. App. 148a-154a. Contrary

to the Government's contention that the court of appeals failed to consider adequately the language of § 3121(a) in its analysis, that court carefully considered § 3121(a) and recognized the substantial identity between § 3121(a)'s definition of "wages" and the definition found in § 3401(a). *See* Pet. App. 8a-10a.

The Government contends that, in holding that the SUB payments at issue here are not subject to FICA tax, the court of appeals "did not suggest that those payments fall outside the applicable definition of wages." Pet. 8. This assertion is incorrect. The court of appeals based its decision, in part, upon this Court's holding in *Coffy* that SUB payments are not "compensation for services" and on the legislative history of 26 U.S.C. § 3402(o) evidencing congressional intent that SUB payments are neither "wages" nor "remuneration for services." Pet. App. 13a.[1]

The Government also notes that § 3121(a) contains many express exclusions from the definition of "wages" and suggests that, absent an express exclusion, § 3121(a) should be read broadly to include SUB payments as wages, citing this Court's decision in *United States v. Silk*, 331 U.S. 704, 711-12 (1947).

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[1] The Government asserts that the legislative history of § 3402(o) "belies any suggestion that the provision was intended to exempt [SUB payments]" from FICA taxation. Pet. 16. That is also incorrect. As the court of appeals noted, the legislative history of § 3402(o) makes clear that Congress did not consider SUB payments "wages" or "remuneration for services." Pet. App. 13a.

Pet. 11. However, the definition of "wages" in the federal income tax withholding chapter, 26 U.S.C. § 3401(a), similarly contains a long list of exclusions that does not include SUB payments; yet the Government concedes, as it must, that at least some SUB payments clearly are considered by Congress to be non-wages for income tax withholding purposes. Pet. 19.

B. In 1969, Congress enacted § 3402(o) of the IRC which expressly recognizes the exclusion of SUB payments from wages. 26 U.S.C. § 3402(o). *See* Pet. App. 174a-179a. The purpose of this section was to authorize the withholding of income taxes from certain types of payments "other than wages," specifically including (i) "supplemental unemployment compensation benefits" (SUB payments), (ii) "annuities" and (iii) "sick pay." *Id.* Section 3402(o)(2) defines each of these three types of non-wages. SUB payments are defined as

> amounts which are paid to an employee, pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment (whether or not such separation is temporary), resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, but only to the extent such benefits are includable in the employee's gross income.

26 U.S.C. § 3402(o)(2)(A). *See also* 26 U.S.C. § 501(c)(17) (adopting an almost identical definition of

SUB payments in 1960 for tax exemption purposes). The parties stipulated that the payments at issue here fall within this statutory definition. Pet. 5.

The language of § 3402(o) strongly supports the conclusion that payments qualifying as SUB payments constitute non-wages. *First*, the statutory text states that SUB payments "shall be *treated as* if [they are] a payment of wages" (for income tax withholding purposes), indicating that SUB payments are *not* wages. As the district court noted, if SUB payments constituted wages, there would be no need to treat them as though they are wages, *i.e.*, the withholding of income taxes would not need to be extended to such payments. Pet. App. 52a-53a.

*Second*, a comparison of the language of subparagraphs (A), (B) and (C) of § 3402(o)(1) supports the conclusion that all SUB payments constitute non-wages. Subparagraph (C) of § 3402(o)(1) refers to any "payment to an individual of sick pay *which does not constitute wages*." The words "which does not constitute wages" are included because payments of sick pay to an individual by an employer *do* constitute wages, whereas payments of sick pay to an individual by a third party, like an insurer, generally *do not* constitute wages. "No tax is specifically required to be withheld upon any wage continuation payment made by a person who is not the employer." S. Rep. No. 96-1033, at 11 (1980); *see also CSX Corp., Inc. v. U.S.*, 52 Fed. Cl. 208, 215 (Fed. Cl. 2002) ("*CSX I*"), *affirmed in part, reversed in part, CSX Corp. v. U.S.*, 518 F.3d 1328 (Fed. Cir. 2008) ("*CSX II*"). Thus, the language

of subparagraph (C) of § 3402(o)(1) recognizes that certain payments of sick pay *do* constitute wages and other payments of sick pay *do not* constitute wages. By contrast, subparagraphs (A) and (B) of § 3402(o)(1) do not distinguish between wages and non-wages because all SUB payments under subparagraph (A) and all annuity payments under subparagraph (B) are non-wages. *See CSX I*, 52 Fed. Cl. at 215-16. While annuity payments were considered "remuneration" when § 3402(o) was enacted, Congress recognized that "present law specifically excludes . . . [such payments] from the definition of wages." *CSX I*, 52 Fed. Cl. at 215 and n.10, quoting S. Rep. No. 91-552 at 268 (1969) and citing 26 U.S.C. §§ 3401(a)(12)(B) and 3121(a)(5)(B) (1964). Based upon the surrounding statutory text, therefore, if the Government's contention that Congress considered some SUB payments to be wages were correct, § 3402(o) would refer to "supplemental unemployment compensation benefits *which do not constitute wages*." *See Kmart Corp. v. Cartier, Inc.*, 486 U.S. 281, 291 (1988) ("In ascertaining the plain meaning of the statute, the court must look to the particular statutory language at issue, as well as the language and design of the statute as a whole.").

*Third*, as the court of appeals noted, the title of § 3402(o) is "Extension of withholding to certain payments *other than wages*." Pet. App. 174a (emphasis added). *See INS v. National Ctr. for Immigrants' Rights, Inc.*, 502 U.S. 183, 189 (1991) ("[T]he title of a statute or section can aid in resolving an ambiguity in the legislation's text.)

Consistent with the congressional intent of promoting ease of administration of the FICA and federal income tax withholding schemes, *Rowan* requires that the definition of wages under FICA (Chapter 24) be construed *in pari materia* with the definitions in the income tax withholding parts of the IRC (Chapter 21). 452 U.S. at 257.[2] Therefore, the court of appeals correctly held that because SUB payments clearly are not wages for federal income tax withholding purposes, SUB payments are also not wages for FICA purposes. Pet. App. 14a-20a.

C. A key element of the argument made by the Government in this case and in *CSX II* rests on the IRS's treatment of "dismissal payments." This argument is a red herring because, as the Government is well aware, the IRS's own definitions of "dismissal payments" and "SUB payments" are very different. *Compare* Treas. Reg. § 31.3401(a)-1(b)(4) (defining "dismissal payments") (*See* Pet. App. 199a-200a) with Treas. Reg. § 31.3401(a)-1(b)(14) (defining "SUB payments"). (*See* Pet. App. 213a-214a). SUB payments not only involve an *involuntary* separation

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[2] Recognizing the interpretive significance of *Rowan*, the Government argued before the Sixth Circuit in this case and the Federal Circuit in *CSX II* that *Rowan* was legislatively overruled by the *Social Security Amendments of 1983, Pub. L. No. 98-21, § 327(b)(1), 97 Stat. 65, 127 (1983) (codified in last para. of 26 U.S.C. § 3121(a))*, the so-called "Decoupling Amendment." Both the Sixth Circuit and the Federal Circuit rejected this argument. *See* Pet. App. 14a-20a; *CSX II*, 518 F.3d at 1343-45. Thus, there is no conflict between the Sixth Circuit and the Federal Circuit regarding the continuing validity of *Rowan*.

from employment, but also require the payments to be made *pursuant to a plan* and in connection with *the closure of a plant or operation or other similar work force reduction, i.e.,* the elimination of the job. *See NYSA-ILA Container Royalty Fund v. Commissioner,* 847 F.2d 50, 53 (2d Cir. 1988) (acknowledging the Government's argument that SUB payments and dismissal payments are "mutually exclusive categories").[3]

D. Pursuant to the Decoupling Amendment, Congress granted authority to the Treasury Department to issue regulations defining exclusions from "wages" for FICA purposes differently than exclusions from "wages" for federal income tax withholding purposes. IRC § 3121(a). As noted by both the Sixth Circuit in this case and the Federal Circuit in *CSX II*, however, the IRS has failed to issue FICA regulations under the Decoupling Amendment that address SUB payments, much less specifically adopt a position contrary to the deemed wage treatment for income tax withholding purposes. *See* Pet. App. 14a-16a; *CSX II*, 518 F.3d at 1343-45. *See also Anderson v. United*

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[3] The Government's construction of SUB payments may adversely impact the statutory framework set up between the federal government and state governments for eligibility for unemployment benefits and extended unemployment benefits. The provisions for extended unemployment benefits expressly incorporate the statutory definition of SUB payments (26 U.S.C. § 501(c)(17)) into their eligibility requirements. *See, e.g.*, 26 U.S.C. 3304(a)(11) and section 202(a)(3)(D) of the *Federal-State Extended Unemployment Compensation Act of 1970, Pub. L. No. 91-373, 84 Stat. 695 (1970), as amended by P.L. 96-499, 94 Stat. 2659 (1980).*

*States*, 929 F.2d 648, 650-51, 653 n.10 (Fed. Cir. 1991) (noting the Treasury Department's failure to issue relevant regulations pursuant to the Decoupling Amendment). In the absence of such FICA regulations, the Government ignores the only Treasury regulations that address this issue[4] and, instead, asks this Court to give deference to certain administrative rulings issued by the IRS between 1956 and 1990 through which, the Government contends, the IRS developed a "framework" for establishing whether and when SUB payments are not wages. But the revenue rulings issued on this topic were not consistent. Indeed, as the court of appeals noted, Rev. Rul. 77-347, 1977-2 C.B. 362, issued in 1977 (although subsequently "modified") supports the lower courts' interpretation of the statute. Pet. App. 27a. Rev. Rul. 80-124, 1980-1 C.B. 212, does the same. *Id.* (stating that "[s]upplemental unemployment benefits [as defined in § 3402(o)] are not wages *under sections 3121(a) and 3306(b) of the Code*") (emphasis in the original).[5] Nor, as the District Court noted, do the revenue rulings have the authoritative import of Treasury regulations. Pet. App. 51a. In short, this is not a case involving longstanding and consistent

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[4] The Treasury Department issued relevant information reporting regulations (implementing IRC § 6041) and SUB payment federal income tax withholding regulations (implementing IRC § 501(c)(17)) that reflect congressional intent to exclude SUB payments from wages. *See infra*, pp. 17-20.

[5] The Petition does not mention either Rev. Rul. 77-347 or Rev. Rul. 80-124.

interpretation of Treasury regulations entitled to judicial deference. *See United States v. Cleveland Indians Baseball Co.*, 532 U.S. 200, 219-20 (2001). The court of appeals found the revenue rulings to be inconsistent and in conflict with congressional intent. Pet. App. 22a-29a.

## II. There Is No Conflict That Warrants This Court's Review.

The Government contends that the court of appeals' decision conflicts with decisions of this Court and of other courts of appeals. *See* Pet. 20-25. Contrary to the Government's contention, there is no conflict with any decision of this Court or of the regional courts of appeals. Although the decision in this case diverges from decisions of the Federal Circuit, there are strong reasons not to grant immediate review on the basis of that shallow conflict.

A. In order to allege a conflict, the Government frames a question that is considerably broader than the question actually considered and decided by the court of appeals in this case. The Petition asks this Court to decide "whether severance payments made to employees whose employment was involuntarily terminated are taxable under the Federal Insurance Contributions Act." Pet. i. The issue actually decided by the court of appeals is whether payments made (i) pursuant to a plan to which the employer was a party, (ii) to employees whose employment was involuntarily terminated, (iii) where the employees' separation

from employment resulted directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions (*i.e.*, SUB payments), are taxable under FICA.

Apart from the Federal Circuit's decisions in *CSX II* and *Abrahamsen v. United States*, 228 F.3d 1360 (Fed. Cir. 2000), *cert. denied*, 532 U.S. 957 (2001), the decisions of the courts of appeals cited by the Government do not conflict with the court of appeals' decision in this case because they all involved payments made to employees who had accepted some form of *voluntary* separation from employment or payments otherwise materially different in character from SUB payments. *See University of Pittsburgh v. United States*, 507 F.3d 165 (3d Cir. 2007) (early retirement payments made to faculty members who voluntarily retired were wages subject to FICA tax); *Appoloni v. United States*, 450 F.3d 185 (6th Cir. 2006) (severance payments made to public school teachers who agreed to resign and relinquish their statutory tenure rights and their teaching positions were wages subject to FICA tax); *North Dakota State Univ. v. United States*, 255 F.3d 599 (8th Cir. 2001) (severance payments made to university administrators under voluntary early retirement program were wages subject to FICA tax); *Hemelt v. United States*, 122 F.3d 204 (4th Cir. 1997) (payments under settlement of wrongful discharge claims were wages not "tort-based awards"); *Rivera v. Baker West, Inc.*, 430 F.3d 1253 (9th Cir. 2005) (payments made under settlement agreement resolving claims for discrimination and wrongful termination

constituted "back pay" subject to federal income tax withholding). While some of the payments in *Abrahamsen* were to former employees who had been involuntarily separated, that case did not involve SUB payments. SUB payments involve not only the dismissal of an employee but the elimination of the job. *See* 26 U.S.C. § 3402(o)(2)(A); *Coffy*, 447 U.S. at 200-01.

Moreover, the Petition does not cite or discuss the Second Circuit's decision in *NYSA-ILA Container Royalty Fund v. Comm'r*, 847 F.2d 50 (2d Cir. 1988), which favorably discusses § 3402(o)'s definition of SUB payments as the applicable test for FICA purposes. In *NYSA-ILA* the Government took a position contrary to its positions before the Sixth Circuit in this case and the Federal Circuit in *CSX II*, arguing that SUB payments and dismissal payments are "mutually exclusive categories." *Id.* at 53.

B. The Government contends that excluding SUB payments from the definition of wages conflicts with this Court's decision in *Social Security Board v. Nierotko*, 327 U.S. 358 (1946). Pet. 7-8, 20-22. The court of appeals clearly considered *Nierotko*'s broad construction of "wages" under FICA. Pet. App. 8a-9a. The Court went on to note, however, that *Coffy v. Republic Steel Corp.*, 447 U.S. 191 (1990), a more recent decision of this Court, held that SUB payments fall outside the broad statutory meaning of wages. Pet. App. 6a-7a, 9a. Moreover, *Nierotko* involved "back pay," a type of payment that clearly

differs from SUB payments. Indeed, SUB payments did not exist when *Nierotko* was decided.

The Petition also cites this Court's decision in *Otte v. United States*, 419 U.S. 43 (1974), but that case is inapposite. The issue in *Otte* was whether unpaid wages paid by a bankruptcy trustee to former employees were exempt from federal income tax withholding and FICA taxes merely because the payments were made by the trustee and not the employer. This Court held the payments were clearly wages subject to federal income tax withholding and FICA taxes because the original character of the payments as wages was not altered by the fact that the trustee, rather than the employer, was the payor. *Id.* at 49-50.

C. The court of appeals' decision in this case diverges from the Federal Circuit's decision in *CSX II*, but that disagreement does not warrant immediate review by this Court, for at least two reasons.

1. The disagreement between the Sixth Circuit and the Federal Circuit may have no practical effect. By statute, all taxpayers who file a claim for a tax refund may choose between filing their claims (i) in a federal district court (or bankruptcy court),[6] with an

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[6] *See United States v. Bond*, 486 B.R. 9 (E.D.N.Y. 2012) (confirming the constitutional authority of bankruptcy courts to hear and finally determine claims for tax refunds against the IRS in the wake of *Stern v. Marshall*, 131 S.Ct. 2594 (2011)).

appeal to one of the regional courts of appeals, or (ii) in the Court of Federal Claims, with an appeal to the Federal Circuit. *See* 28 U.S.C. § 1295(a)(3) (limiting the jurisdiction of the Federal Circuit in civil tax cases to appeals from the Court of Federal Claims); 28 U.S.C. § 1346(a) (giving the Court of Federal Claims jurisdiction to adjudicate claims for federal tax refunds filed by taxpayers). Following the Federal Circuit's decision in *CSX II*, few if any taxpayers are likely to file refund claims in the Court of Federal Claims. Instead, taxpayers are likely to file such claims in the district courts (or bankruptcy courts), so that any appeals will be decided by one of the regional circuits.[7] If other courts of appeals follow the Sixth Circuit's decision in this case, taxpayers will be treated in a uniform way and the Federal Circuit's decision in *CSX II* will have limited practical significance. Accordingly, there is no pressing need for this Court to review the issue at this time.

2. The usual reasons for denying review of a shallow circuit split are particularly compelling in this case. The Federal Circuit viewed the statutory construction issue as "complex," and thought "that the correct resolution of the issue is far from obvious." *CSX II*, 518 F.3d at 1340. The Sixth Circuit agreed

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[7] Such cases are already pending. *See, e.g.*, *Alliant Techsystems, Inc. v. United States of America*, Case No. 0:12-cv-00807-SRN-FLN (U.S.D.C. Minn.); *Kimberly-Clark Corporation v. United States of America*, Case No. 3:12-cv-01168-L (U.S.D.C. N. Tex.); and *Citigroup, Inc. v. United States of America*, Case No. 3:12-cv-00591-JCH (U.S.D.C. Conn.).

with this assessment. Pet. App. 30a. In such cases, decisions from more than two federal courts of appeals may be of assistance to this Court.

D. The second reason why immediate review by this Court is not warranted is the fact that regulatory and administrative authority that was cited to the Sixth Circuit in this case was not cited to the Federal Circuit in *CSX II*. The American Payroll Association, in its amicus curiae briefs filed with the Sixth Circuit in this case, informed the court that the Treasury Department adopted final regulations in 1968 addressing information reporting requirements which provided that SUB payments of $600 or more must be reported on annual information returns (*i.e.*, Forms 1099-MISC). *See* Treas. Reg. § 1.501(c)(17)-2(j). Treas. Reg. § 1.6041-2(b). T.D. 6972, 1968-2 C.B. 222, 229 and 239; 33 Fed. Reg. 12899 (September 12, 1968). Forms 1099-MISC, *Miscellaneous Income*, cannot be used to report either FICA wages, FITW wages or the withheld payroll taxes on such wages. Only Forms W-2, *Wage and Tax Statement* are used for those purposes. Thus, at the time Congress was considering § 3402(o) (and writing its legislative history), the relevant Treasury regulations had imposed Form 1099 information reporting on SUB payments, thereby recognizing that SUB payments were exempt from *any* type of wage withholding (FICA, the Federal Unemployment Tax Act, 26 U.S.C. §§ 3301-3311 ("FUTA") or FITW).

Immediately after § 3402(o) was enacted, the Treasury Department issued regulations, forms, and

publications[8] to assist payroll administrators in the implementation of § 3402(o) and its deemed treatment of SUB payments as wages for federal income tax withholding purposes. In addition to restating and reissuing the prior information reporting regulations for pre-1971 years, the then-new Treas. Reg. §§ 1.501(c)(17)-2(j) and 1.6041-2(b) contemplated that Form W-2 reporting would replace Form 1099 reporting

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[8] Although not authoritative guidance, the forms and publications issued to employers and payroll administrators were modified by the IRS in 1971 to implement § 3402(o)'s deemed wage treatment. In describing the practical impact of the statutory SUB payment definition for payroll compliance purposes, in the 1971 version of Circular E, Employer's Tax Guide, the IRS explained that SUB payments were subject to FITW, but exempt from FICA and FUTA taxes. *See* Circular E, Employer's Tax Guide, I.R.S. Pub. No. 15 (1971). To help illustrate this new FITW distinction, the 1971 Circular E included a chart which provided that SUB-Pay is taxable for FITW purposes, but exempt from wages for both FICA and FUTA purposes. *Id.* at 13-16. In calculating taxable wages, the 1971 Circular E also specifically warned employers when preparing payroll tax returns: "Do not include the amount of any . . supplemental unemployment compensation benefit from which income tax has been withheld." *Id.*, at 11-12; *see also id.* at 5, 9, and 16. The IRS also released a 1971 Form 941E, Quarterly Return of Withheld Federal Income Tax for reporting SUB payments subject to FITW wage treatment. *See* Quarterly Return of Withheld Federal Income Tax, I.R.S. Form 941E (1971). No FICA wages or FICA taxes were or could be reported on the 1971 Form 941E by the SUB payment trusts. Similar special rules were adopted for SUB payments in the 1971 version of Form 941, Employer's Quarterly Tax Return. *See* Employer's Quarterly Tax Return, I.R.S. Form 941 (1971). The foregoing authority was cited to the Sixth Circuit in this case but not to the Federal Circuit in *CSX II*.

for most, but not all, statutory SUB payment benefits paid after December 31, 1970. *See* T.D. 7068, 1970-2 C.B. 252; 35 Fed. Reg. 17328 (November 11, 1970). Form 1099 reporting imposed on SUB payments was superseded by Form W-2 reporting only if the SUB payments were subject to federal income tax withholding under § 3402(o). *See* Treas. Reg. § 1.501(c)(17)-2(j). Form W-2 reporting was not triggered "in lieu of such annual [Form 1099] information return" if, for example, the terminated employee claimed exempt status, claimed personal allowances sufficient to avoid withholding, or received payments below the minimum withholding threshold amounts. If SUB payments were wages for FICA purposes (as the Government now claims), then any Form 1099 reporting would have been impermissible. Thus, the IRS regulatory structure adopted in 1970, which remains in effect today, contemplates that the Form W-2 wage reporting is limited to federal income tax withholding under § 3402(o).

In short, the regulations, forms, and publications promulgated by the IRS at the time § 3402(o) was enacted confirm Congress' position that SUB payments are *not* wages for FICA purposes and are only deemed wages solely for federal income tax withholding purposes. It is possible that these additional materials and arguments could cause the Federal Circuit to reconsider its position, particularly if other circuits agree with the Sixth Circuit's interpretation in this case. At a minimum, the Court would benefit from allowing the additional materials and arguments to be considered by other courts of appeals.

E. Finally, as both the Sixth Circuit in this case and the Federal Circuit in *CSX II* noted, the Treasury Department has not availed itself of its authority under the Decoupling Amendment to address this issue through regulations. Pet. App. 15a-16a; *CSX II*, 518 F.3d at 1343-45. This Court generally does not intervene to resolve a controversy that the Treasury Department could seek to address through the regulatory authority granted by Congress. *See United States v. Cleveland Indians Baseball Co.*, 532 U.S. at 218-19.

## CONCLUSION

The Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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# REPLY BRIEF

No. 12-1408

# In the Supreme Court of the United States

UNITED STATES OF AMERICA, PETITIONER

*v.*

QUALITY STORES, INC., ET AL.

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT*

## REPLY BRIEF FOR THE PETITIONER

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## TABLE OF CONTENTS

Page

A. The question presented is recurring and exceptionally important ..... 1
B. The decision below conflicts with decisions of this Court and other courts of appeals ..... 2
C. The decision below is incorrect ..... 7

## TABLE OF AUTHORITIES

Cases:

*Appoloni* v. *United States*, 450 F.3d 185 (6th Cir. 2006), cert. denied, 549 U.S. 1165 (2007) ..... 5
*CSX Corp.* v. *United States*, 518 F.3d 1328 (Fed. Cir. 2008) ..... 2, 3, 4, 8, 11
*Coffy* v. *Republic Steel Corp.*, 447 U.S. 191 (1980) ..... 10, 11
*NYSA-ILA Container Royalty Fund* v. *Commissioner*, 847 F.2d 50 (2d Cir. 1988) ..... 5, 6
*North Dakota State Univ.* v. *United States*, 255 F.3d 599 (8th Cir. 2001) ..... 5
*Otte* v. *United States*, 419 U.S. 43 (1974) ..... 7
*Rowan Cos.* v. *United States*, 452 U.S. 247 (1981) ..... 11
*Social Sec. Bd.* v. *Nierotko*, 327 U.S. 358 (1946) ..... 6, 7
*University of Pittsburgh* v. *United States*, 507 F.3d 165 (3d Cir. 2007) ..... 5
*Yee* v. *City of Escondido*, 503 U.S. 519 (1992) ..... 3

Statutes and regulation:

Act of Dec. 24, 1980, Pub. L. No. 96-601, 94 Stat. 3496 ..... 10
Federal Insurance Contributions Act, 26 U.S.C. 3101 *et seq.* ..... 1

Statutes and regulation—Continued: Page

26 U.S.C. 3121(a) (2006 & Supp. V 2011) .....5, 6
26 U.S.C. 3121(b) (2006 & Supp. V 2011) .....5, 6, 7
Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 708 .....10
26 U.S.C. 501(c)(17) .....3
26 U.S.C. 3402(*o*) .....*passim*
26 U.S.C. 3402(*o*)(1) .....8
26 U.S.C. 3402(*o*)(1)(A) .....3, 8, 9, 10
26 U.S.C. 3402(*o*)(1)(C) .....9, 10
26 U.S.C. 3402(*o*)(2)(A) .....8, 11
Treas. Reg. § 1.501(c)(17)-2(j) (as amended by 35 Fed. Reg. 17,328 (Nov. 11, 1970)) .....4

Miscellaneous:

Rev. Rul. 90-72, 1990-2 C.B. 211 .....6
S. Rep. No. 1033, 96th Cong., 2d Sess. (1980) .....10

# In the Supreme Court of the United States

No. 12-1408

UNITED STATES OF AMERICA, PETITIONER

*v.*

QUALITY STORES, INC., ET AL.

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT*

## REPLY BRIEF FOR THE PETITIONER

The question presented in this case is whether severance payments made by an employer to terminated employees are taxable under the Federal Insurance Contributions Act (FICA), 26 U.S.C. 3101 *et seq.* Respondents do not dispute that the question is recurring and exceptionally important, and they concede (Br. in Opp. 13) that the Sixth and Federal Circuits have answered the question differently. With thousands of refund claims and cases worth a combined total of more than $1 billion currently wending their way through the Internal Revenue Service (IRS) and lower courts, the importance of the issue and the square circuit conflict clearly call for this Court's review.

### A. The Question Presented Is Recurring And Exceptionally Important

Respondents do not dispute that the proper tax treatment of severance pay under FICA is a recurring

issue of exceptional importance. According to the IRS, that question is currently pending in at least eleven cases and more than 2400 administrative refund claims, with a total amount at stake of more than $1 billion. The decision below also has significant potential implications with respect to the administration of Social Security and Railroad Retirement Act benefits. See Pet. 25. The importance of the question presented for the public fisc, as well as for employers and employees in the Sixth Circuit, alone warrants this Court's review.

**B. The Decision Below Conflicts With Decisions Of This Court And Other Courts Of Appeals**

1. Respondents acknowledge that the decision below "diverges from the Federal Circuit's decision" in *CSX Corp.* v. *United States*, 518 F.3d 1328 (2008). Br. in Opp. 16. Respondents contend, however, that the circuit conflict does not warrant this Court's review because taxpayers may seek refunds either "(i) in a federal district court (or bankruptcy court), with an appeal to one of the regional courts of appeals, or (ii) in the Court of Federal Claims, with an appeal to the Federal Circuit." *Id.* at 16-17 (footnote omitted). Respondents argue that, because the Federal Circuit has ruled in the government's favor, taxpayers are likely to file refund suits in the district courts (or bankruptcy courts) rather than in the Court of Federal Claims, thus diminishing the ongoing practical significance of the Federal Circuit's decision. See *id.* at 17.

As explained below, the Sixth Circuit's reasoning is unpersuasive, and there is no reason to assume that other courts of appeals will prefer it to the Federal Circuit's contrary approach in *CSX Corp.* See Part C, *infra*. In any event, the fact that taxpayers who seek to assert refund claims may have a choice of fora is *more*

reason, not less, for this Court's review. Cf. *Yee* v. *City of Escondido*, 503 U.S. 519, 538 (1992) (observing that "[f]orum shopping" is "of particular concern" where plaintiffs may obtain different results in a given jurisdiction by filing suit in either state or federal court).

Respondents also argue (Br. in Opp. 18) that review is not warranted because they cited 1968 Treasury regulations to the Sixth Circuit that were not before the Federal Circuit in *CSX Corp.* In the decision below, however, the Sixth Circuit did not even mention, let alone rely on, those regulations. Those regulations did not relate to the proper tax treatment of severance pay under FICA, but instead concerned the payment of supplemental unemployment compensation benefits by tax-exempt trusts under 26 U.S.C. 501(c)(17). When the regulations were issued in 1968, such supplemental payments—*i.e.*, payments tied to state unemployment benefits—were not treated as "wages" subject to either FICA tax or income-tax withholding. As a result, supplemental unemployment benefit payments did not have to be reported on IRS Form W-2, which is normally used to report wages. But supplemental payments still had to be reported as taxable non-wage income, which meant that taxpayers found themselves subject to substantial tax obligations when they filed their returns. See Pet 16; *CSX Corp.*, 518 F.3d at 1336.

In 1969, at the Treasury Department's suggestion, Congress enacted 26 U.S.C. 3402(*o*) to address that particular problem. Section 3402(*o*) provides that "any supplemental unemployment compensation benefit paid to an individual * * * shall be treated as if it were a payment of wages by an employer to an employee for a payroll period." 26 U.S.C. 3402(*o*)(1)(A). Following Section 3402(*o*)'s enactment, the IRS amended its regulations to

require tax-exempt trusts to report supplemental unemployment benefit payments on Form W-2. See Treas. Reg. § 1.501(c)(17)-2(j) (as amended by 35 Fed. Reg. 17,328 (Nov. 11, 1970)). In other words, once Congress provided that such payments were to be treated as wages for income-tax withholding purposes, the IRS amended its regulations to require the reporting of supplemental unemployment benefit payments as wages. The 1968 regulations are thus entirely consistent with the history of Section 3402(*o*) set forth in the government's petition. See Pet. 16-17.

Respondents further contend that the IRS could "address this issue through regulations." Br. in Opp. 21. But the Sixth Circuit declined to defer to the IRS's Revenue Rulings on the ground that those Rulings were "inconsistent with the intent of Congress as expressed in the statutes and the legislative history." Pet. App. 22a. The Sixth Circuit thus held that, under Section 3402(*o*), "the expressed will of the legislature" is that the severance payments at issue here "are not subject to FICA tax." *Id.* at 28a-29a. As part of its analysis, the Sixth Circuit suggested that the IRS lacked any regulatory authority to treat severance payments as subject to taxation under FICA. See *id.* at 29a ("And where a promulgated Treasury regulation has no power to alter a statute Congress enacted, neither does a revenue ruling."). It is thus not clear that the IRS could resolve the current circuit conflict by issuing regulations.

2. Respondents argue (Br. in Opp. 14-15) that, although the Third and Eighth Circuits have joined the Federal Circuit in holding that various types of severance payments are "wages" for FICA purposes, those decisions are distinguishable because the payments at issue in those cases were made as a result of voluntary

rather than involuntary separation. The text of FICA, however, draws no such distinction. It defines "wages" to include "all remuneration" paid for "any service" performed by an employee—without regard to whether there is a continuing employment relationship or why that relationship may have ceased. 26 U.S.C. 3121(a) and (b) (2006 & Supp. V 2011). Accordingly, the Third and Eighth Circuits (and even the Sixth Circuit in a previous decision) have not viewed the determination whether a severance payment constitutes "wages" for FICA purposes as turning on the voluntary or involuntary nature of an employee's separation. See *University of Pittsburgh* v. *United States*, 507 F.3d 165, 171-174 (3d Cir. 2007); *North Dakota State Univ.* v. *United States*, 255 F.3d 599, 605-608 (8th Cir. 2001); see also *Appoloni* v. *United States*, 450 F.3d 185, 189-194 (6th Cir. 2006), cert. denied, 549 U.S. 1165 (2007).

To be sure, the nature of an employee's separation might be relevant if, as respondents contend, Section 3402(*o*) governed the tax treatment of a severance payment under FICA. As the petition for certiorari explains, however, the Third, Eighth, and Federal Circuits have not treated Section 3402(*o*) as in any way relevant to the determination whether particular payments are FICA "wages." See Pet. 23. Those decisions reinforce the conclusion that this Court's review is necessary to prevent disuniformity in the administration of federal tax laws.[1]

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[1] Respondents contend (Br. in Opp. 15) that the government took a contrary position in *NYSA-ILA Container Royalty Fund* v. *Commissioner*, 847 F.2d 50 (2d Cir. 1988). That is incorrect. As the petition explains (Pet. 11-14), between 1956 and 1990 the IRS issued numerous Revenue Rulings that addressed whether particular payments to terminated employees should be treated as "wages" for both income-

3. Respondents acknowledge that this Court's decision in *Social Security Board* v. *Nierotko*, 327 U.S. 358 (1946), applied the "broad statutory meaning" of the term "wages" in FICA. Br. in Opp. 15 (discussing *Nierotko*'s "broad construction of 'wages' under FICA"). FICA defines "wages" as "all remuneration" paid for "any service, of whatever nature, performed * * * by an employee for the person employing him." 26 U.S.C. 3121(a) and (b) (2006 & Supp. V 2011). This Court in *Nierotko* recognized that FICA's broad definition of "wages" encompasses an award of back pay because such a payment is based on, and made on account of, "the entire employer-employee relationship." 327 U.S. at 366.

Respondents attempt to distinguish *Nierotko* on the ground that back pay is "a type of payment that clearly differs" from the severance payments at issue in this case. Br. in Opp. 15-16. But the amounts of the severance payments at issue in this case depended on particular employees' level of seniority, length of service with the company, and regular rate of pay. Those are all factors that depend on "the entire employer-employee relationship," *Nierotko*, 327 U.S. at 366, and all of them are

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tax withholding and FICA purposes. The IRS concluded that payments made to terminated employees were "wages" unless they were "linked to state unemployment compensation" and "designed to supplement the receipt of state unemployment compensation." Rev. Rul. 90-72, 1990-2 C.B. 211, 212. The government's brief in *NYSA-ILA Container Royalty Fund* set forth that same position: supplemental unemployment benefit payments—as defined by the IRS's Revenue Rulings—are not "wages" for FICA purposes. See Gov't Br. at 16-18, 18 n.*, *NYSA-ILA Container Royalty Fund*, *supra* (No. 87-6267). Under the IRS's longstanding approach, the severance payments at issue here are clearly "wages" for FICA purposes because they are wholly unconnected to state unemployment compensation.

usual factors associated with determining the level of an employee's compensation. The decision below therefore cannot be reconciled with this Court's reasoning in *Nierotko*.

**C. The Decision Below Is Incorrect**

Respondents argue at length (Br. in Opp. 4-13) that the decision below is correct. Even if respondents' arguments on the merits had greater force, the case would still warrant this Court's review in light of the square circuit conflict and the administrative importance of the question presented. In any event, respondents fail to offer a persuasive defense of the Sixth Circuit's decision.

1. Respondents assert that severance payments are not made in return for "any service, of whatever nature, performed" by an employee, 26 U.S.C. 3121(b) (2006 & Supp. V 2011), but are instead made for "the 'elimination of employment' due to plant shutdowns and similar conditions," Br. in Opp. 4. A severance payment, however, compensates a terminated employee for his *past* service to his employer, regardless of the reason for his termination. In *Otte* v. *United States*, 419 U.S. 43 (1974), this Court recognized that an employer may continue to pay "wages" after an employment relationship has ended. See *id.* at 49-50 (observing that because FICA defines wages as remuneration for services that an employee "performs or *performed*," the statutory language "speaks in the past tense as well as the present and thereby plainly reveals that a continuing employment relationship is not a prerequisite for a payment's qualification as 'wages'") (emphasis added). And even if the severance payments at issue here were viewed exclusively as compensation for loss of future employment, they would still be "wages" under *Nierotko*, which in-

volved compensation for work that the employee was not allowed to perform.

2. As the petition for certiorari explains, the court of appeals did not hold that the severance payments at issue here fall outside FICA's definition of "wages." See Pet. 8, 11. Although respondents defend the Sixth Circuit's textual analysis, they, like the court of appeals, rely on Section 3402(*o*) rather than on FICA. See Br. in Opp. 6.

By its terms, Section 3402(*o*)(1) applies only to Chapter 24 (income-tax withholding) and certain related procedural matters. See Pet. 15-16. FICA is codified at Chapter 21, not Chapter 24. As the Federal Circuit has explained, "Congress's decision to restrict the scope of the rule set forth in [S]ection 3402(*o*) to [C]hapter 24 suggests that Congress did not intend that rule, or any implication that might be drawn from that rule, to be applied outside the context of income tax withholding." *CSX Corp.*, 518 F.3d at 1341. Respondents offer no answer to the Federal Circuit's reasoning; they do not attempt to ground their position in the literal text of Section 3402(*o*)(1); and they do not explain why the court of appeals was justified in looking beyond FICA's definition of "wages" and drawing inferences from Section 3402(*o*).

Section 3402(*o*)(1)(A) provides that "any supplemental unemployment compensation benefit," as that term is defined in Section 3402(*o*)(2)(A), "shall be treated as if it were a payment of wages." Respondents infer (Br. in Opp. 8) that whatever the statute defines as a "supplemental unemployment compensation benefit" cannot itself be wages. That inference ignores the history of Section 3402(*o*), which respondents do not address. See Pet. 16-17. Congress defined the term "supple-

mental unemployment compensation benefit" broadly to include *both* the payments linked to state unemployment compensation that the IRS had historically treated as non-wage income, *and* various types of dismissal payments that the IRS had viewed as "wages," in order to ensure that both types of payments were subject to income-tax withholding. There was no reason for Congress to define the term more narrowly, because mandating withholding for all types of payments—some that were already subject to withholding and some that were not—created no practical difficulties. See Pet. 17-18.

By contrast, respondents' interpretation of Section 3402(*o*)(1)(A) brings that provision into conflict with more than 60 years of IRS practice. See Pet. 18. If Congress had wanted to eliminate FICA withholding from the sorts of dismissal payments that the IRS had historically treated as wages, the language it used in Section 3402(*o*)—which addresses income-tax withholding rather than FICA taxation, and which *expands* the range of payments that are subject to withholding—would have been a remarkably indirect way of accomplishing that result. Respondents offer no reason why Congress would have chosen such a circuitous route. Nor do they identify any evidence that, in subjecting "supplemental unemployment compensation benefit[s]" to income-tax withholding through the enactment of Section 3402(*o*), Congress sought to exempt from FICA taxation any payments that had previously been treated as FICA "wages."

Respondents also rely (Br. in Opp. 8-9) on Section 3402(*o*)(1)(C), which authorizes (but does not require) income-tax withholding from "sick pay which does not constitute wages." 26 U.S.C. 3402(*o*)(1)(C). The limiting language "which does not constitute wages" reflects

Congress's evident understanding that some sick pay was already treated as "wages." Respondents argue that the absence of similar language in Section 3402(*o*)(1)(A) suggests a different congressional understanding with respect to supplemental unemployment compensation benefits.

That inference is unwarranted. Section 3402(*o*)(1)(C)'s special withholding rule applies only "if at the time the payment is made a request that such sick pay be subject to withholding under this chapter is in effect." 26 U.S.C. 3402(*o*)(1)(C); see S. Rep. No. 1033, 96th Cong., 2d Sess. 3 (1980) (explaining that "this section of the bill provides for *voluntary* withholding from payments of sick pay made by a third party") (emphasis added). Given that limitation, the phrase "which does not constitute wages" serves an important purpose, by making clear that no such "request" is necessary to trigger income-tax withholding from sick pay that is *already* treated as "wages." Because Section 3402(*o*)(1)(A) contains no similar limitation, no practical harm results from the provision's application to payments that constituted wages under pre-existing law. See Pet. 17-18.[2]

3. Contrary to respondents' contentions (Br. in Opp. 4, 6), this Court's decision in *Coffy* v. *Republic Steel Corp.*, 447 U.S. 191 (1980), has no bearing on the question presented here. In *Coffy*, the Court held that payments to laid-off employees were "perquisites of seniori-

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[2] In addition, Section 3402(*o*)(1)(C) was added to the statute in 1980, see Act of Dec. 24, 1980, Pub. L. No. 96-601, § 4(a), 94 Stat. 3496, 11 years after Section 3402(*o*)'s original enactment in 1969, see Tax Reform Act of 1969, Pub. L. No. 91-172, § 805(g), 83 Stat. 708; and it therefore sheds little light on Congress's intent in enacting the original provision.

ty" under the Vietnam Era Veterans' Readjustment Assistance Act of 1974, because the payments at issue were "in the nature of a reward for length of service, and [did] not represent deferred short-term compensation for services actually rendered." *Id.* at 205-206. But *Coffy* did not address whether the payments were "wages" for either FICA or income-tax withholding purposes. And *Nierotko* makes clear that a payment may constitute "wages" for those purposes even if it does not compensate an employee for the performance of specific tasks or functions. FICA's expansive definition of "wages" encompasses compensation (like a bonus or severance payment) that accounts more generally for an employee's entire performance over some period of time. See Pet. 10.

4. Respondents' reliance (Br. in Opp. 4-5, 10) on *Rowan Cos.* v. *United States*, 452 U.S. 247 (1981), is likewise misplaced. In *Rowan*, the Court observed that the term "wages" is defined "substantially the same" for both income-tax withholding and FICA purposes, *id.* at 255, and the Court reasoned that the benefits at issue (meals and lodging) should be treated the same for both purposes, see *id.* at 263. That general equivalence is of no help to respondents here, however, since they identify no sound reason to conclude that the severance payments at issue in this case are not "wages" for purposes of income-tax withholding. Respondents' argument depends on the premise that *all* payments encompassed by Section 3402(*o*)(2)(A)'s definition of "supplemental unemployment compensation benefits" must be treated as non-wage payments for all purposes other than income-tax withholding. As the government has explained, and as the Federal Circuit correctly recognized in *CSX Corp.*, 518 F.3d at 1344-1345, the negative inference that

respondents seek to draw from Section 3402(*o*) is not justified by its text, history, and purpose.

* * * * *

For the foregoing reasons and those stated in the petition for a writ of certiorari, the petition for a writ of certiorari should be granted.

Respectfully submitted.

DONALD B. VERRILLI, JR.
*Solicitor General*

AUGUST 2013

# JOINT APPENDIX

Supreme Court, U.S.
FILED
NOV 8 - 2013
OFFICE OF THE CLERK

No. 12-1408

# In the Supreme Court of the United States

UNITED STATES OF AMERICA, PETITIONER

*v.*

QUALITY STORES, INC., ET AL.

*ON WRIT OF CERTIORARI*
*TO THE UNITED STATES COURT OF APPEALS*
*FOR THE SIXTH CIRCUIT*

## JOINT APPENDIX

DONALD B. VERRILLI, JR.
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PETITION FOR A WRIT OF CERTIORARI FILED: MAY 21, 2013
CERTIORARI GRANTED: OCT. 1, 2013

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## TABLE OF CONTENTS

Page

Court of appeals docket entries ..... 1

District court docket entries ..... 11

Bankruptcy court docket entries ..... 21

Complaint for turnover of property of debtors' estate (June 1, 2005) ..... 38

Joint stipulation of undisputed facts (Aug. 15, 2006) ..... 47

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

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Docket No. 10-1563

QUALITY STORES, INC., ET AL., PLAINTIFF-APPELLEE

*v.*

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

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**DOCKET ENTRIES**

| DATE | PROCEEDINGS |
|---|---|
| 4/27/10 | Bankruptcy Case Docketed. Notice filed by Appellant USA. Transcript needed: n. (SB) |
| 4/27/10 | The case manager for this case is: Sue Burlage (513) 564-7012 (SB) |
| 4/27/10 | BRIEFING LETTER SENT setting briefing schedule: appellant brief due 6/11/2010; appellee brief due 7/13/2010. (SB) |
| 4/27/10 | APPEARANCE filed for Appellant USA by Francesca U. Tamami. Certificate of Service: 04/27/2010. (FU) |
| 4/27/10 | APPEARANCE filed for Appellee Quality Stores, Inc. by Michael H. Reed, Esq.. Certificate of Service: 04/27/2010. (MHR) |
| 4/30/10 | CIVIL APPEAL STATEMENT OF PARTIES AND ISSUES filed by Attorney Ms. Francesca U. Tamami for Appellant USA. Certificate of Service: 04/30/2010. (FU) |

| DATE | PROCEEDINGS |
|---|---|
| 4/30/10 | TRANSCRIPT ORDER FORM filed by Ms. Francesca U. Tamami for USA; Transcript on file in district court. Certificate of Service: 04/30/2010. (FU) |
| 5/4/10 | APPEARANCE filed for Appellees Quality Stores, Inc., et al. by Robert S. Hertzberg. Certificate of Service: 5/04/2010.—[Edited 05/04/2010 by SB] (RSH) |
| 5/5/10 | APPEARANCE filed for Appellee Quality Stores, Inc. by Nina M. Varughese. Certificate of Service: 05/05/2010. (NMV) |
| 5/25/10 | MOTION filed by Ms. Francesca U. Tamami for USA to extend time to file brief. Certificate of Service: 05/25/2010. (FU) |
| 5/25/10 | LETTER SENT granting appellant's motion to extend time to file brief [4189253-2]. Resetting briefing schedule: appellant brief now due 7/13/2010; appellee brief now due 8/17/2010. (SB) |
| 5/26/10 | MOTION filed by Mr. Michael H. Reed for Quality Stores, Inc. to extend time to file brief. Certificate of Service: 05/26/2010. (MHR) |
| 5/28/10 | LETTER SENT granting appellee's motion to extend time to file brief [4190126-2]. Resetting briefing schedule: appellant brief (unchanged) 7/13/2010; appellee brief now due 9/08/2010. (SB) |

| DATE | PROCEEDINGS |
|---|---|
| 7/13/10 | APPEARANCE filed for Appellant USA by Kenneth L. Greene. Certificate of Service: 07/13/2010. (KLG) |
| 7/13/10 | APPEARANCE filed for Appellant USA by Gilbert S. Rothenberg. Certificate of Service: 07/13/2010. (GSR) |
| 7/13/10 | APPELLANT BRIEF filed by Ms. Francesca U. Tamami for USA. Certificate of Service: 07/13/2010. Argument Request: requested. (FU) |
| 9/8/10 | APPELLEE BRIEF filed by Mr. Michael H. Reed for Quality Stores, Inc.. Certificate of Service: 09/08/2010. Argument Request: requested. (MHR) |
| 9/15/10 | APPEARANCE filed for Amicus Curiae American Payroll Association by Christopher A. Weals. Certificate of Service: 09/15/2010. (CAW) |
| 9/15/10 | DISREGARD--form needs to be filed by attorney Fuller [APPEARANCE filed for Amicus Curiae American Payroll Association by David R. Fuller. Certificate of Service: 09/15/2010.] —[Edited 09/15/2010 by SB] (CAW) |
| 9/15/10 | DISREGARD—form needs to be filed by attorney Hevener [APPEARANCE filed for Amicus Curiae American Payroll Association by Mary B. Hevener. Certificate of Service: 9/15/2010.]—[Edited 09/15/2010 by SB] (CAW) |

| DATE | PROCEEDINGS |
|---|---|
| 9/15/10 | MOTION to file AMICUS BRIEF and to participate in oral argument filed by Christopher A. Weals for American Payroll Association. Certificate of Service: 09/15/2010. [consent of the parties on page 2]—[Edited 09/15/2010 by SB] (CAW) |
| 9/15/10 | AMICUS BRIEF filed by Mr. Christopher Alan Weals for American Payroll Association. Certificate of Service: 09/15/2010. (CAW) |
| 9/15/10 | APPEARANCE filed for Amicus Curiae ERISA Industry Committee by Robert A. Long. Certificate of Service: 09/15/2010. (RAL) |
| 9/15/10 | AMICUS BRIEF filed by Mr. Robert Allen Long, Jr. for ERISA Industry Committee. Certificate of Service: 09/15/2010. [with consent of the parties on page 1]—[Edited 09/15/2010 by SB] (RAL) |
| 9/17/10 | RESPONSE in opposition filed regarding a motion to file amicus brief & participate in oral argument [4249620-2] previously filed by American Payroll. Response from Attorney Ms. Francesca U. Tamami for Appellant USA. Certificate of Service: 09/17/2010.—[Edited 08/03/2011 by SB] (FU) |

| DATE | PROCEEDINGS |
|---|---|
| 9/24/10 | REPLY filed by Mr. Christopher Alan Weals for American Payroll Association regarding *Appellant's Opposition to Motion for Leave to Participate in Oral Argument.* Certificate of Service: 09/24/2010. (CAW) |
| 9/27/10 | REPLY BRIEF filed by Attorney Ms. Francesca U. Tamami for Appellant USA. Certificate of Service: 09/27/2010. (FU) |
| 1/31/11 | ADDITIONAL CITATION filed by Ms. Francesca U. Tamami for USA. Certificate of Service: 01/31/2011. (FU) |
| 2/2/11 | RESPONSE filed regarding an additional citation, [4326960-2]. Response from Attorney Mr. Michael H. Reed for Appellee Quality Stores, Inc.. Certificate of Service: 02/02/2011. (MHR) |
| 8/3/11 | Oral argument date set for 1:30 P.M. Thursday, October 6, 2011. Notice of argument sent to counsel on 08/03/2011. (DTS) |
| 8/4/11 | Oral argument acknowledgement filed by Attorney Ms. Francesca U. Tamami for Appellant USA. Certificate of Service: 08/04/2011. (FU) |
| 8/12/11 | Oral argument acknowledgement filed by Attorney Mr. Robert S. Hertzberg for Appellee Quality Stores, Inc.. Certificate of Service: 08/12/2011. (RSH) |

| DATE | PROCEEDINGS |
|---|---|
| 9/9/11 | ORDER filed granting American Payroll Association's motion to file an amicus brief [4249620-2]. The portion of the motion requesting participation in oral argument is denied. Entered by order of the court. (SB) |
| 9/19/11 | MOTION filed by Mr. Michael H. Reed for Quality Stores, Inc. to split/share argument time. Certificate of Service: 09/19/2011. (MHR) |
| 9/22/11 | ORDER filed granting appellees' motion to split/share argument time [4465745-2] filed by Mr. Michael H. Reed. Counsel is to notify the court of how the time will be split. Danny J. Boggs and Jane Branstetter Stranch, Circuit Judges; James G. Carr, U.S. District Judge. (SB) |
| 9/23/11 | LETTER filed by Mr. Michael H. Reed for Quality Stores, Inc. regarding */Appellees Letter regarding share of appellees argument time.* Certificate of Service: 09/23/2011. (MHR) |
| 10/6/11 | AMICUS APPEARANCE filed by Attorney Mr. David R. Fuller for Amicus Curiae American Payroll Association. Email Consent: y. (SB) |
| 10/6/11 | AMICUS APPEARANCE filed by Attorney Ms. Mary B. Hevener for Amicus Curiae American Payroll Association. Email Consent: y. (SB) |

| DATE | PROCEEDINGS |
|---|---|
| 10/6/11 | CAUSE ARGUED by Ms. Mary B. Hevener for Amicus Curiae American Payroll Association; Ms. Francesca U. Tamami for Appellant USA; and Mr. Robert S. Hertzberg for Appellee Quality Stores, Inc. before Circuit Judges Boggs and Stranch and U.S. District Judge Carr. (DTS) |
| 7/6/12 | LETTER filed by Mr. Michael H. Reed for Quality Stores, Inc. regarding / *Appellees Letter regarding additional citation.* Certificate of Service: 07/06/2012. (MHR) |
| 7/6/12 | NOTICE OF DOCKETING ERROR, ENTRY LOCKED. Name of Document: misc. letter from attorney Michael Reed. Please docket again under ECF category Briefing + additional citation(28j) (SB) |
| 7/6/12 | ADDITIONAL CITATION filed by Mr. Michael H. Reed for Quality Stores, Inc.. Certificate of Service: 07/06/2012. (MHR) |
| 7/9/12 | RESPONSE filed regarding a additional citation [4647431-2] previously filed by Mr. Michael H. Reed in 10-1563. Response from Attorney Ms. Francesca U. Tamami for Appellant USA Certificate of Service: 07/09/2012.—[Edited 07/09/2012 by SB] (FU) |

| DATE | PROCEEDINGS |
|---|---|
| 9/7/12 | OPINION and JUDGMENT filed: The judgment of the district court is AFFIRMED. Decision for publication pursuant to local rule 206. Danny J. Boggs and Jane Branstetter Stranch (AUTHORING), Circuit Judges; and James G. Carr, U.S. District Judge for the Northern District of Ohio, sitting by designation. (CL) |
| 10/2/12 | MANDATE ISSUED with no costs taxed. (SB) |
| 10/4/12 | ORDER filed to recall mandate. (SB) |
| 10/18/12 | PETITION for en banc rehearing filed by Ms. Francesca U. Tamami for USA. Certificate of Service: 10/18/2012. (FU) |
| 11/13/12 | The case manager for this case is now: Cheryl Borkowski (CB) |
| 12/4/12 | LETTER SENT to Mr. Robert S. Hertzberg for Quality Stores, Inc., notifying that he is directed to respond to petition for en banc rehearing filed by Ms. Francesca U. Tamami. Response due 12/18/2012. (BLH) |
| 12/14/12 | RESPONSE to petition for en banc rehearing, [4715834-2], previously filed by filed by Ms. Francesca U. Tamami in 10-1563. Response filed by Mr. Michael H. Reed for Quality Stores, Inc.. Certificate of service: 12/14/2012. (MHR) |

| DATE | PROCEEDINGS |
|---|---|
| 12/18/12 | NOTICE OF DOCKETING ERROR, ENTRY REMOVED. Name of Document: MOTION to file AMICUS BRIEF filed by Christopher A. Weals for American Payroll Association. Type of Error: proposed brief attached. Action taken: TENDERED. (BLH) |
| 12/18/12 | Motion filed by Mr. Christopher Alan Weals for American Payroll Association for leave to file a brief as amicus curiae in opposition to appellant's petition for rehearing en banc. Certificate of service: 12/18/2012. (BLH) |
| 12/18/12 | TENDERED brief in opposition to appellant's petition for rehearing en banc. Received from Attorney Mr. Christopher Alan Weals for American Payroll Association. (BLH) |
| 12/20/12 | RESPONSE in opposition filed regarding a motion to allow amicus, [4758085-2]; previously filed by Mr. Christopher Alan Weals in 10-1563. Response from Attorney Ms. Francesca U. Tamami for Appellant USA Certificate of Service: 12/20/2012. (FU) |
| 12/27/12 | ORDER filed granting motion for leave to file a brief as amicus curiae in opposition to appellant's petition for rehearing en banc [4758085-2] filed by Mr. Christopher Alan Weals. Entered by order of the court. (BLH) |

| DATE | PROCEEDINGS |
|---|---|
| 12/27/12 | AMICUS BRIEF filed by Mr. Christopher Alan Weals for American Payroll Association in opposition to appellant's petition for rehearing en banc. Copies: electronic. Certificate of Service: 12/27/2012. (BLH) |
| 1/4/13 | ORDER filed denying petition for en banc rehearing [4715834-2] filed by Ms. Francesca U. Tamami. Danny J. Boggs and Jane Branstetter Stranch, Circuit Judges; and James G. Carr, District Judge. (BLH) |
| 1/16/13 | MANDATE ISSUED with no costs taxed. (CB) |
| 6/4/13 | U.S. Supreme Court notice filed regarding a petition for a writ of certiorari filed by Appellant USA. Supreme Court Case No: 12-1408, 05/31/2013. (CL) |
| 10/1/13 | U.S. Supreme Court letter filed granting the petition for a writ of certiorari [4871126-2] filed by USA. Supreme Court Case No: 12-1408, 10/01/2013.. (CL) |

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF MICHIGAN
(Southern Division (1))

No. 1:09-cv-00044-JTN

UNITED STATES OF AMERICA, APPELLANT

*v.*

QUALITY STORES, INC., ET AL., APPELLEE

**DOCKET ENTRIES**

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| 1/21/09 | 1 | Notice of APPEAL FROM BANKRUPTCY COURT: Bankruptcy Court case number 01-10662, Adversary Proceeding No. 05-80573; file received filed by Daniel M. LaVille (Attachments: # 1 Attachment 1—Appellants Notice of Appeal, # 2 Attachment 2—Clerks Notice Regarding Record on Appeal, # 3 Attachment 3—Appellants Designation of Items to be Included in the Record on Appeal with Statement of Issues, # 4 Attachment 4—Bankruptcy Courts Docket in Adversary Proceeding No. 05-80573, # 5 Attachment 5—Statement of Election to Have Appeal Heard by District Court, # 6 Attachment 6—Final |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| | | Judgment signed by Judge James D. Gregg, # 7 Attachment 7—Motion for Entry of Judgment with attachments, # 8 Attachment 8—Order Adjourning Hearing signed by Judge James D. Gregg, # 9 Attachment 9—Notice of Appearance and Substitution of Counsel by L. Steven Schifano, # 10 Attachment 10—Order Granting Defendants Motion for Reconsideration and Order Ratifying Prior Opinion and Order signed by Judge James D. Gregg, # 11 Attachment 11—Motion for Reconsideration of Opinion and Order Regarding Severance Pay and FICA Contributions, # 12 Attachment 12—Order Regarding Severance Pay and FICA Contributions signed by Judge James D. Gregg, # 13 Attachment 13—Opinion Regarding Severance Pay and FICA Contributions signed by Judge James D. Gregg, # 14 Attachment 14—Transcript of Hearing held November 15, 2006, # 15 Attachment 15—United States Opposition to Plaintiffs Cross-Motion for Summary Judgment, # 16 Attachment 16—Plaintiffs Memorandum in Opposition to Defendants Cross-Motion for Summary Judgment, # 17 At- |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| | | tachment 17—Exhibits to the United States Cross-Motion for Summary Judgment, # 18 Attachment 18—United States Cross-Motion for Summary Judgment and Supporting Brief, # 19 Attachment 19—Plaintiffs Cross Motion for Summary Judgment, Supporting Brief and Supporting Exhibits, # 20 Attachment 20—Joint Stipulation of Undisputed Facts, # 21 Attachment 21—Order Granting Motion of Natalie Hoyer Keller to Appear Pro Hac Vice signed by Judge James D. Gregg, # 22 Attachment 22—Stipulation and Agreed Order Substituting Defendant signed by Judge James D. Gregg, # 23 Attachment 23—Notice of Appearance by Michael L. Shiparski, # 24 Attachment 24—United States Answer, # 25 Attachment 25—Certificate of Service of Summons, # 26 Attachment 26—Summons, # 27 Attachment 27—Complaint, # 28 Attachment 27—Complaint—Exhibit A, # 29 Attachment 27—Complaint—Exhibit B-1, # 30 Attachment 27—Complaint—Exhibit B-2, # 31 Attachment 27—Complaint—Exhibit B-3, # 32 Attachment 27—Complaint—Exhibit |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| | | B-4, # 33 Attachment 28—Order Confirming First Amended Joint Plan of Reorganization, # 34 Attachment 28—Order Confirming First Amended Joint Plan of Reorganization—Exhibits, # 35 Attachment 29—First Amended Disclosure Statement for the Joint Plan of Reorganization, # 36 Attachment 29—First Amended Disclosure Statement for the Joint Plan of Reorganization —Exhibit A, # 37 Attachment 29—First Amended Disclosure Statement for the Joint Plan of Reorganization —Exhibit B, # 38 Attachment 29—First Amended Disclosure Statement for the Joint Plan of Reorganization —Exhibit C, # 39 Attachment 29—First Amended Disclosure Statement for the Joint Plan of Reorganization —Exhibit D, # 40 Attachment 29—First Amended Disclosure Statement for the Joint Plan of Reorganization —Exhibit E, # 41 Attachment 29—First Amended Disclosure Statement for the Joint Plan of Reorganization —Exhibit F, # 42 Attachment A—Appellees Counter-Designation of the Record and Statement of Issues on Appeal, # 43 Attachment B—Order Granting Joint Stipulation to |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| | | Substitute Robert S. Hertzberg, Michael H. Reed and Benjamin M. Mater in Place of Janet S. Baer and Natalie Hoyer Keller signed by Judge James D. Gregg, # 44 Attachment C—Corrected Stipulation to Substitute Counsel, # 45 Attachment D—Notice of Appearance by Michael H. Reed, # 46 Attachment E—Notice of Appearance by Robert S. Hertzberg, # 47 Attachment F—Notice of Appearance by Benjamin M. Mather) (U.S. Bankruptcy Clerk, dbv) (Entered: 01/21/2009) |
| 1/21/09 | 2 | NOTICE OF TRANSMITTAL from Clerk, Bankruptcy Court, Western District of Michigan re 1 (U.S. Bankruptcy Clerk, dbv) (Entered: 01/21/2009) |
| 1/21/09 | 3 | BRIEF REQUIREMENT NOTICE: appellant brief due by 2/5/2009 appellee brief due within 15 days after service of the brief of the appellant (cr) (Entered: 01/21/2009) |
| 1/21/09 | | Copy of Bankruptcy Brief Requirement Notice 3 sent via U.S. Mail to Office of the United States Trustee and Daniel M. LaVille (cr) (Entered: 01/21/2009) |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| 1/26/09 | 4 | PROPOSED STIPULATION and ORDER *Request For Extension To Brief Requirement Deadlines* by appellant United States of America, appellee Quality Stores, Inc. et al (Mather, Benjamin) (Entered: 01/26/2009) |
| 1/28/09 | 5 | Memorandum regarding potentially related case returned to Clerk from Magistrate Judge Ellen S. Carmody indicating that this case Is Related to 1:06-cv-876 and 1:06-cv-306 (cr) Modified date on 1/29/2009 (cr). (Entered: 01/29/2009) |
| 1/29/09 | 6 | ORDER approving stipulation 4 signed by Judge Janet T. Neff (Judge Janet T. Neff, sas) (Entered: 01/29/2009) |
| 1/29/09 | | Copy of Stipulation and Order 6 sent via U.S. Mail to Office of the United States Trustee and Daniel M. LaVille (pjw) (Entered: 01/29/2009) |
| 3/9/09 | 7 | BRIEF (Oral Argument Requested per 12) by appellant United States of America appellee brief due within 15 days after service of the brief of the appellant (Schifano, L.) Modified text on 5/29/2009 to include request for oral argument (jlg). (Entered: 03/09/2009) |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| 4/27/09 | 8 | BRIEF by appellee Quality Stores, Inc. (Reed, Michael) (Entered: 04/27/2009) |
| 4/30/09 | 9 | NOTICE *of Substitution of Counsel.* by appellee Quality Stores, Inc. (Reed, Michael) (Entered: 04/30/2009) |
| 4/30/09 | 10 | ATTORNEY APPEARANCE of Nina M. Varughese on behalf of appellee Quality Stores, Inc. (Varughese, Nina) (Entered: 04/30/2009) |
| 5/22/09 | 11 | REPLY BRIEF (Oral Argument Requested per 12) by appellant United States of America (Schifano, L.) Modified text on 5/29/2009 to include request for oral argument (jlg). (Entered: 05/22/2009) |
| 5/28/09 | 12 | NOTICE re 8 , 11 , 7 *Request for Oral Argument* by appellant United States of America (Schifano, L.) (Entered: 05/28/2009) |
| 2/23/10 | 13 | OPINION; Order to issue; signed by Judge Janet T. Neff (Judge Janet T. Neff, clb) (Entered: 02/23/2010) |
| 2/23/10 | 14 | ORDER in accordance with Opinion; signed by Judge Janet T. Neff (Judge Janet T. Neff, clb) (Entered: 02/23/2010) |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| 2/24/10 | | Copy of Order 14 , Opinion 13 sent via U.S. Mail to Office of the United States Trustee (jlg) (Entered: 02/24/2010) |
| 3/1/10 | 15 | RETURNED MAIL: Copy of Opinion 13, Order 14 that was sent via U.S. Mail to Office of the United States Trustee returned to the Court marked not deliverable as addressed, unable to forward; corrected zip code from 49053 to 49503 and remailed (jlg) (Entered: 03/01/2010) |
| 3/4/10 | 16 | RETURNED MAIL: Copy of Opinion 13 and Order 14 that was sent via U.S. Mail to Office of the United States Trustee returned to the Court marked not deliverable as addressed unable to forward; updated address to 125 Ottawa NW, Ste. 200R, Grand Rapids, MI 49503 and remailed (jlg) (Entered: 03/04/2010) |
| 4/23/10 | 17 | NOTICE OF APPEAL re 14 , 13 by appellant United States of America (Schifano, L.) (Entered: 04/23/2010) |
| 4/26/10 | | Copy of Notice of Appeal 17 and docket sheet sent via U.S. Mail to Office of the United States Trustee (jlg) (Entered: 04/26/2010) |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| 4/29/10 | | CASE NUMBER 10-1563 assigned by the Sixth Circuit to appeal 17 (elc) (Entered: 04/29/2010) |
| 5/7/10 | 18 | NOTICE re 17 *Designation of Record and Issues on Appeal* by appellant United States of America (Schifano, L.) (Entered: 05/07/2010) |
| 9/22/11 | 19 | ORDER of USCA re appeal 17 *granting appellees' motion to split/share argument time with amicus curiae American Payroll Association* (pjw) (Entered: 09/22/2011) |
| 9/7/12 | 20 | USCA OPINION AND JUDGMENT re appeal 17 *affirming the judgment of the district court; mandate to issue* (jlg) Modified text on 9/7/2012 (jlg). (Entered: 09/07/2012) |
| 10/2/12 | 21 | MANDATE of USCA re appeal 17 (pjw) (Entered: 10/03/2012) |
| 10/4/12 | 23 | ORDER of USCA re appeal 17 *recalling as premature the mandate issued on 10/2/2012* (pjw) Modified text on 1/17/2013 (pjw). (Entered: 01/17/2013) |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| 1/4/13 | 22 | ORDER of USCA re appeal 17 *indicating the petition for rehearing en banc is denied* (pjw) Modified text on 1/7/2013 (pjw). (Entered: 01/07/2013) |
| 1/16/13 | 24 | MANDATE of USCA re appeal 17 (pjw) (Entered: 01/17/2013) |
| 6/4/13 | 25 | LETTER from Supreme Court of the United States that a petition for writ of certiorari was filed by United States of America on May 31, 2013 and assigned case number 12-1408 re Notice of Appeal 17 (dfw) (Entered: 06/05/2013) |
| 10/1/13 | 26 | LETTER from Supreme Court of the United States that the petition for writ of certiorari is granted re Notice of Appeal 17 (pjw) (Entered: 10/02/2013) |

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF MICHIGAN
(Grand Rapids)

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Adversary Proceeding No. 05-80573-jdg

QUALITY STORES, INC., ET AL., PLAINTIFF

*v.*

UNITED STATES OF AMERICA, DEFENDANT

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**DOCKET ENTRIES**

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| 6/1/05 | 1 | 454 (Recover Money/Property): Complaint by Quality Stores, Inc., et al., against United States of America Department of Treasury Internal Revenue Service. Fee Amount $150. (Attachments: 1 Exhibit A2 Exhibit B-13 Exhibit B-24 Exhibit B-35 Exhibit B-46 Adversary Proceeding Cover Sheet) (Schulman, Rachel) (Entered: 06/01/2005) |
| 6/1/05 | | Receipt of filing fee for Complaint (05-80573) [cmp,cmp] (150.00). Receipt number 1297588, amount $ 150.00 (U.S. Treasury) (Entered: 06/01/2005) |
| 6/2/05 | 2 | Summons Issued on United States of America Department of Treasury Internal Revenue Service Date Is- |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| | | sued 6/2/2005, Answer Due 7/2/2005 (dr,) (Entered: 06/02/2005) |
| 6/16/05 | 3 | Summons Service Executed on United States of America Department of Treasury Internal Revenue Service 6/2/2005 (Schulman, Rachel) (Entered: 06/16/2005) |
| 07/7/05 | 4 | Answer to Complaint Filed by United States of America Department of Treasury Internal Revenue Service. (Davis, Elizabeth) (Entered: 07/07/2005) |
| 7/15/05 | 5 | Pretrial Hearing Set (1) Complaint filed by Plaintiff Quality Stores, Inc., et al.,. Pre-Trial Conference set for 9/26/2005 at 10:00 AM at Judge Gregg's Courtroom. (dgs) notice forwarded to noticing center for service. (Entered: 07/15/2005) |
| 7/17/05 | 6 | BNC Certificate of Mailing—Court's Notice of Hearing. Service Date 07/17/2005. (Admin.) (Entered: 07/18/2005) |
| 7/25/05 | 7 | Notice of rescheduled Hearing. 1 Complaint filed by Plaintiff Pre-Trial Conference rescheduled for 8/24/2005 at 02:00 PM at Judge Gregg's Courtroom. (dgs) notice forwarded to noticing center for ser- |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| | | vice. (Entered: 07/25/2005) |
| 7/27/05 | 8 | BNC Certificate of Mailing—Court's Notice of Hearing. Service Date 07/27/2005. (Admin.) (Entered: 07/28/2005) |
| 8/2/05 | 9 | Notice of Appearance/Request for Notice by Defendant United States of America Department of Treasury Internal Revenue Service. (Attachments: 1 Certificate of Service (Interested Parties)) (Shiparski, Michael) (Entered: 08/02/2005) |
| 8/23/05 | 10 | Notice of Appearance/Request for Notice by Defendant United States of America Department of Treasury Internal Revenue Service. (Davis, Michael) (Entered: 08/23/2005) |
| 8/23/05 | 11 | Certificate of Service (RE: related document(s) 10 Notice of Appearance/Request for Notice). Filed by Defendant United States of America Department of Treasury Internal Revenue Service (Davis, Michael) (Entered: 08/23/2005) |
| 8/24/05 | | Hearing Continued (RE: related document(s) 1 Complaint, filed by Plaintiff Quality Stores, Inc., et al.,) Pre-Trial Conference set for 10/27/2005 at 11:00 AM at Judge Gregg's |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| | | Courtroom (Courtroom B). (may participate by phone) (klb,) (Entered: 08/31/2005) |
| 10/11/05 | 12 | Stipulated Proposed Order *Substituting Defendant.* Filed by Plaintiff Quality Stores, Inc., et al., (Schulman, Rachel) (Entered: 10/11/2005) |
| 10/12/05 | 13 | Stipulated Order Substituting Defendant between Plaintiff and Defendant. Signed on 10/12/2005 (klb,) (Entered: 10/13/2005) |
| 10/27/05 | | Status Hearing Held (RE: related document(s) 1 Complaint, filed by Plaintiff Quality Stores, Inc., et al.,) Pre-Trial Conference set for 1/3/2006 at 11:00 AM at Judge Gregg's Courtroom (Courtroom B). (attorney may appear by phone) (klb,) (Entered: 10/31/2005) |
| 12/30/05 | 14 | Motion To Admit Counsel, Natalie Hoyer Keller, pro hac vice Filed by Plaintiff Quality Stores, Inc., et al., (Attachments: 1 Proposed Order) (klb,) (Entered: 01/03/2006) |
| 1/3/06 | | Pretrial Hearing Conducted (RE: related document(s) 1 Complaint, filed by Plaintiff Quality Stores, Inc., et al.,) Second Pre-Trial Conference |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| | | set for 4/17/2006 at 11:30 AM eastern time at Judge Gregg's Courtroom (Courtroom B). Court to prepare order. (attorneys may appear by phone) (klb,) (Entered: 01/05/2006) |
| 1/4/06 | 15 | First Pretrial Order. Discovery shall remain open until further order of the court. (RE: related document(s) 1 Complaint, filed by Plaintiff Quality Stores, Inc., et al.,). Pre-Trial Conference set for 4/17/2006 at 11:30 AM eastern standard time at Judge Gregg's Courtroom (Courtroom B). Signed on 1/4/2006 (klb,) (Entered: 01/06/2006) |
| 1/5/06 | 16 | Order Granting Motion of Natalie Hoyer Keller to Appear pro hac vice. (Related Doc # 14) Signed on 1/5/2006. (klb,) (Entered: 01/09/2006) |
| 1/10/06 | 17 | Bill of Costs to Natalie Hoyer Keller in the Amount of $35.00 for Pro Hac Vice Admission (pin, admin) Additional attachment(s) added on 1/11/2006 (pin, admin). (Entered: 01/10/2006) |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| 1/10/06 | 18 | Letter from Hon. James D. Gregg to Ms. Keller Regarding: Pro Hac Vice fee due. (RE: related document(s) 16 Order on Motion to Appear pro hac vice) (klb,) (Entered: 01/11/2006) |
| 3/20/06 | | Notice of Adjourned Telephonic Second Pretrial Conference (RE: related document(s) 1 Complaint, filed by Plaintiff Quality Stores, Inc., et al.,) Pre-Trial Conference set for 4/19/2006 at 10:00 AM at Judge Gregg's Courtroom (Courtroom B). (klb,) (Entered: 03/20/2006) |
| 3/20/06 | 19 | Notice of Adjourned Telephonic Second Pretrial Conference (RE: related document(s) 1 Complaint, filed by Plaintiff Quality Stores, Inc., et al.,) Pretrial 4/19/06 at 10:00 AM in Grand Rapids. (klb,) (Entered: 03/20/2006) |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| 4/18/06 | | Pretrial Hearing Conducted (RE: related document(s) 1 Complaint, filed by Plaintiff Quality Stores, Inc., et al.,) Parties to file cross motions for summary judgment by 9/1/06. Summary Judgment hrg. scheduled for 10/12/06 at 9:00 AM (morning reserved) (klb,) (Entered: 04/25/2006) |
| 4/20/06 | 20 | Second Pretrial Order. Discovery shall remain open until 7/28/06. (RE: related document(s) 1 Complaint, filed by Plaintiff Quality Stores, Inc., et al.,). Hearing on Cross Motions for Summary Judgment set for 10/12/2006 at 09:00 AM at Judge Gregg's Courtroom (Courtroom B). Signed on 4/20/2006 (klb,) (Entered: 04/25/2006) |
| 8/15/06 | 21 | Stipulation of Facts (*Undisputed*). (Attachments: 1 Exhibit A2 Exhibit B) Filed by Plaintiff Quality Stores, Inc., et al., (Baer, Janet) (Entered: 08/15/2006) |
| 9/1/06 | 22 | Motion For Summary Judgment (*Cross Motion for Summary Judgment*) Filed by Plaintiff Quality Stores, Inc., et al., (Attachments: 1 Memorandum of Law2 Exhibit I to Memorandum of Law3 Exhibit II to |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| | | Memorandum of Law4 Exhibit III to Memorandum of Law5 Proposed Order) (Baer, Janet) (Entered: 09/01/2006) |
| 9/1/06 | 23 | Motion For Summary Judgment Filed by Defendant United States of America (Attachments: 1 Brief/ Memorandum Memorandum of Law in Support of the United States' Cross-Motion for Summary Judgment 2 Certificate of Service (Interested Parties) Certificate of Service) (Davis, Michael) (Entered: 09/01/2006) |
| 9/4/06 | 24 | Exhibit List *and Exhibits to United States' Motion for Summary Judgment* (RE: related document(s) 23 Motion For Summary Judgment). (Attachments: 1 Exhibit Revenue Ruling 90-722 Exhibit Social Security Amendments of 19833 Exhibit S. Rep. 98-234 Exhibit H. Rep. 98-432(II)5 Exhibit H. Rep. 98-25(I)6 Certificate of Service (Interested Parties)) Filed by Defendant United States of America (Davis, Michael) (Entered: 09/04/2006) |
| 9/21/06 | 25 | Scheduling Order (RE: related document(s) 22 Motion for Summary Judgment, filed by Plaintiff Quality |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| | | Stores, Inc., et al.,, 23 Motion for Summary Judgment, filed by Defendant United States of America). Hearing scheduled for 10/25/2006 at 11:00 AM at Judge Gregg's Courtroom (Courtroom B). Signed on 9/21/2006 (klb,) (Entered: 09/22/2006) |
| 10/6/06 | 26 | Memorandum in Opposition to (related document(s): 23 Motion for Summary Judgment,, 24 Exhibit List,) Filed by Plaintiff Quality Stores, Inc., et al., (Attachments: 1 Certificate of Service (Interested Parties)) (Baer, Janet). Modified on 10/12/2006 (bjs) (Entered: 10/06/2006) |
| 10/06/06 | 27 | Opposition to (related document(s): 22 Motion for Summary Judgment,) Filed by Defendant United States of America (Davis, Michael) Modified on 10/12/2006 (bjs) (Entered: 10/06/2006) |
| 10/25/06 | | Hearing Continued (RE: related document(s) 23 Motion for Summary Judgment, filed by Defendant United States of America, 22 Motion for Summary Judgment, filed by Plaintiff Quality Stores, Inc., et al.,) Hearing to be held on 11/15/2006 at |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| | | 11:00 AM Judge Gregg's Courtroom (Courtroom B) for 23 and for 22, (klb,) (Entered: 10/26/2006) |
| 11/15/06 | | Adjourned Hearing Held (RE: related document(s) 22 Motion for Summary Judgment, filed by Plaintiff Quality Stores, Inc., et al., 23 Motion for Summary Judgment, filed by Defendant United States of America). Oral Argument Held. Matter Taken Under Advisement. (lsw,) (Entered: 11/20/2006) |
| 11/24/06 | 28 | Transcript of Hearing Held on 11/15/06 (klb,) (Entered: 11/28/2006) |
| 2/21/08 | 29 | Opinion Regarding Severance Pay and FICA Contributions. (RE: related document(s)22 Motion for Summary Judgment, filed by Plaintiff Quality Stores, Inc., et al.,, 23 Motion for Summary Judgment, filed by Defendant United States of America). Signed on 2/21/2008 (klb) (Entered: 02/21/2008) |
| 2/21/08 | 30 | Order Regarding Severance Pay and FICA Contributions (Related Doc # 22), (Related Doc # 23) Signed on 2/21/2008. (klb) (Entered: 02/21/2008) |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| 2/21/08 | | Transmitted to BNC for Service upon Opinion List (RE: related document(s) 29 Opinion) (rrr) (Entered: 02/21/2008) |
| 3/17/08 | 31 | Scheduling Order (RE: related document(s) 1 Complaint, filed by Plaintiff Quality Stores, Inc., et al.,). Telephonic Status Confernece hearing to be held on 5/15/2008 at 11:30 AM). Signed on 3/17/2008 (klb) (Entered: 03/18/2008) |
| 4/7/08 | 32 | Order Re-Scheduling Telephonic Status Conference (RE: related document(s) 1 Complaint, filed by Plaintiff Quality Stores, Inc., et al). Telephonic Status Conference Hearing scheduled for 5/19/2008 at 01:00 PM). Signed on 4/7/2008 (lsw) (Entered: 04/08/2008) |
| 5/16/08 | 33 | Motion to Reconsider (related documents 29 Opinion and Order,, 30 Order on Motion For Summary Judgment,) Filed by Defendant United States of America (Attachments: 1 Exhibit CSX Corp. v. U.S, 518 F.3d 1328 (Fed. Cir. 2008)) (Davis, Michael) (Entered: 05/16/2008) |
| 5/19/08 | | Telephonic Status Conference Hearing Held (RE: related docu- |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| | | ment(s) 1 Complaint, filed by Plaintiff Quality Stores, Inc., et al.,) (klb) (Entered: 05/20/2008) |
| 8/29/08 | 34 | Order Granting Defendants Motion For Reconsideration and Order Ratifying Prior Opinion and Order (RE: related document(s) 30 Order on Motion For Summary Judgment,, 33 Motion to Reconsider, Reinstate, Vacate, Set Aside or Revoke filed by Defendant United States of America, 29 Opinion and Order, ). Hearing scheduled for 10/16/2008 at 01:00 PM at Judge Gregg Courtroom (Courtroom B). Signed on 8/29/2008 (vak) (Entered: 09/04/2008) |
| 10/3/08 | 35 | Notice of Appearance and Substitution of Counsel by L. Steven Schifano on behalf of Defendant United States of America. (pin) Additional attachment(s) added on 10/9/2008 (Nichol, P.). (Entered: 10/09/2008) |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| 10/16/08 | 36 | Order Adjourning Hearing (RE: related document(s) 1 Complaint filed by Plaintiff Quality Stores, Inc., et al.,, 34 Scheduling Order). Hearing scheduled for 12/1/2008 at 11:00 AM at Judge Gregg Courtroom (Courtroom B). Signed on 10/16/2008 (vak) (Entered: 10/21/2008) |
| 11/20/08 | 37 | Motion for Entry of Judgment Filed by Defendant United States of America (Attachments: 1 Stipulation 2 Proposed Order Final Judgment 3 Certificate of Service (Interested Parties)) (Schifano, L.) Modified on 11/20/2008 (rrr). (Entered: 11/20/2008) |
| 11/25/08 | 38 | Final Judgment (Related Doc # 37) Signed on 11/25/2008. (lsw) (Entered: 11/25/2008) |
| 12/2/08 | 39 | Notice of Appeal. Fee Amount $255 Filed by Defendant United States of America (RE: related document(s) 38 Order on Generic Motion). Appellant Designation due by 12/12/2008. (Attachments: 1 Certificate of Service (Interested Parties)) (Schifano, L.) (Entered: 12/02/2008) |
| 12/2/08 | 40 | Statement of Election to Have Appeal Heard by District Court Filed |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| | | by Defendant United States of America (RE: related document(s)39 Notice of Appeal). (Attachments: 1 Certificate of Service (Interested Parties)) (Schifano, L.) (Entered: 12/02/2008) |
| 12/2/08 | | Election to Appeal to District Court. (RE: related document(s) 39 Notice of Appeal filed by Defendant United States of America) (dbva) (Entered: 12/03/2008) |
| 12/3/08 | 41 | Clerk's Notice Regarding Record on Appeal with Certificate of Mailing. (RE: related document(s) 39 Notice of Appeal filed by Defendant United States of America) (dbva) (Entered: 12/03/2008) |
| 12/5/08 | 42 | BNC Certificate of Mailing. Service Date 12/05/2008. (Admin.) (Entered: 12/06/2008) |
| 12/10/08 | 43 | Appellant Designation of Contents For Inclusion in Record On Appeal with Statement of Issues Filed by Defendant United States of America (RE: related document(s) 39 Notice of Appeal). Appellee designation due by 12/22/2008. Transmission of Record Due by 01/9/2009. (Attachments: 1 Designation Of Is- |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| | | sue On Appeal 2 Certificate of Service (Interested Parties)) (Schifano, L.) (Entered: 12/10/2008) |
| 12/16/08 | 44 | Notice of Appearance by Plaintiff Quality Stores, Inc., et al.,. (Mather, Benjamin) (Entered: 12/16/2008) |
| 12/16/08 | 45 | Notice of Appearance by Plaintiff Quality Stores, Inc., et al.,. (Mather, Benjamin) (Entered: 12/16/2008) |
| 12/16/08 | 46 | Notice of Appearance by Plaintiff Quality Stores, Inc., et al.,. (Mather, Benjamin) (Entered: 12/16/2008) |
| 12/19/08 | 47 | *Corrected by Entry 48* Stipulation To Substitute Robert S. Hertzberg, Michael H. Reed and Benjamin M. Mather in Place of Janet S. Baer and Natalie Hoyer Keller Filed by Plaintiff Quality Stores, Inc., et al., (Mather, Benjamin) Modified on 12/22/2008 (bjs) (Entered: 12/19/2008) |
| 12/22/08 | 48 | Corrected Stipulation To Substitute Hertzberg, Reed and Mather in Place of Baer and Hoyer Keller Filed by Plaintiff Quality Stores, Inc., et al., (Mather, Benjamin) (Entered: 12/22/2008) |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| 12/22/08 | 49 | Order Granting Joint Stipulated Motion to Substitute Attorney Hertzberg, Reed and Mather, terminating Janet S. Baer and Natalie Hoyer Keller. (Related Doc # 48) Signed on 12/22/2008. (vak) (Entered: 12/22/2008) |
| 12/22/08 | 50 | Appellee Designation of Additional Contents for Inclusion in Record of Appeal Filed by Plaintiff Quality Stores, Inc., et al., (RE: related document(s) 39 Notice of Appeal). (Mather, Benjamin) (Entered: 12/22/2008) |
| 1/20/09 | 51 | Record on Appeal. (RE: related document(s) 39 Notice of Appeal filed by Defendant United States of America) (dbva) (Entered: 01/21/2009) |
| 1/20/09 | 52 | Notice of Transmittal of Record on Appeal to District Court. Case Number: 1:09-cv-44. (RE: related document(s) 39 Notice of Appeal filed by Defendant United States of America, 51 Record on Appeal) (dbva) (Entered: 01/21/2009) |
| 2/23/10 | 53 | Order By District Court Judge Janet T. Neff AFFIRMING Bankruptcy Court (RE: related docu- |

| DATE | DOCKET NUMBER | PROCEEDINGS |
|---|---|---|
| | | ment(s) 38 Final Judgment). Signed on 2/23/2010 (dbva) (Entered: 02/23/2010) |
| 4/23/10 | 54 | Notice of Appeal to Sixth Circuit Court. (RE: related document(s) 53 Order by District Court re: Appeal) (dbva) (Entered: 04/23/2010) |
| 9/7/12 | 55 | Opinion and Judgment By Sixth Circuit Court of Appeals (RE: related document(s)53 Order by District Court re: Appeal). Signed on 9/7/2012 (dbv) (Entered: 09/11/2012) |
| 5/31/13 | 56 | Notice by Supreme Court of filing of Petition for Writ of Certiorari (related documents 55 Opinion and Judgment by Sixth Circuit re: Appeal) (dbv) (Entered: 06/05/2013) |
| 10/1/13 | 57 | Letter from Supreme Court to Court of Appeals Regarding: Granting of Writ of Certiorari. (RE: related document(s) 56 Notice) (dbv) (Entered: 10/02/2013) |

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

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No. GG-01-10662
Chapter 11
Jointly Administered

IN RE: QUALITY STORES, INC., ET AL.,[1] DEBTORS

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Adversary No.

QUALITY STORES, INC. ET AL., PLAINTIFF

*v.*

UNITED STATES OF AMERICA, DEPARTMENT OF THE TREASURY, INTERNAL REVENUE SERVICE, DEFENDANT

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Filed: June 1, 2005

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**COMPLAINT FOR TURNOVER OF PROPERTY OF DEBTORS' ESTATE**

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[1] The Debtors are: QSI Holdings, Inc. (f/k/a CT Holdings, Inc.); Quality Stores, Inc. (f/k/a Central Tractor Farm & Country, Inc.); Country General, Inc.; F and C Holding, Inc.; Farmand-Country.com, LLC; QSI Newco, Inc.; QSI Transportation, Inc.; Quality Farm & Fleet, Inc.; Quality Investments, Inc.; Quality Stores Services, Inc.; and Vision Transportation, Inc.

Honorable James D. Gregg.

Plaintiffs, the post-confirmation estates of Quality Stores, Inc. and the related debtors and debtors in possession (collectively, the "Debtors"), for their Complaint for Turnover of Property of the Estate, allege as follows:

**The Parties**

1. Plaintiffs consist of the post-confirmation estates of the Debtors, which were created on May 13, 2002 (the "Effective Date") pursuant to the Court's Order (the "Confirmation Order") confirming the First Amended Joint Plan of Reorganization (the "Plan").

2. On October 20, 2001, an involuntary petition was filed against the Debtors (the "Involuntary Petition") under Chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code"). On November 1, 2001, Quality Stores, Inc. answered the Involuntary Petition and consented to the entry of an order for relief, and the remaining Debtors commenced voluntary Chapter 11 cases before this Court.

3. From their respective petition dates until the Effective Date, the Debtors operated their business and managed their properties as debtors in possession pursuant to Sections 1107(a) and 1108 of the Bankruptcy Code.

4. Defendant is the United States of America, Department of the Treasury, Internal Revenue Service (the "Defendant" or "IRS"). Quality Stores, Inc., f/k/a Central Tractor Farm & Country did business under Federal ID# 42-1425562 (Central Tract-

or); Federal ID# 38-3244519 (Quality Farm & Fleet); Federal ID# 47-0778047 (Country General, Inc.); and Federal ID# 38-3492930 (Quality Stores Services, Inc.) prior to the liquidation of all operations, which liquidation was completed by mid-February, 2002.

**Jurisdiction and Venue**

5. This Court has jurisdiction over this matter under 28 U.S.C. §§ 157 and 1334. This matter is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2). Venue of this matter is proper in this district pursuant to 28 U.S.C. §§ 1408 and 1409.

6. This adversary proceeding is commenced pursuant to Sections 541, 542 and 505 of the Bankruptcy Code and Rule 7001(1) of the Federal Rules of Bankruptcy Procedure.

**Relief Requested**

7. This Complaint seeks the turnover of $1,000,125 from the IRS for overpaid employer and employee taxes paid pursuant to the Federal Insurance Contributions Act ("FICA") plus interest pursuant to IRC § 6611.

8. The Debtors seek a refund for the overpayment of FICA taxes relating to the payment of supplemental unemployment compensation benefits made to former employees from 1999 through 2002.[2] On Sep-

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[2] The Debtors requested the refund of the Debtors' employer and employee portions of these FICA taxes in the amounts of $571,405 and $428,720, respectively. The Debtors are only requesting the refund of employer and employee FICA taxes where a former employee has executed and delivered consent forms

tember 17, 2002, the Debtors filed 15 separate Form 843's (Claim for Refund and Request for Abatement) with the IRS requesting a total refund in the amount of $1,000,125 for overpayment of FICA taxes (the "FICA Refund"). The IRS has not rendered a decision on the FICA Refund.[3]

**Allegations**

9. FICA is a tax imposed upon the wages of employees to fund Social Security programs and Medicare insurance. Internal Revenue Code ("IRC") § 3101; *see Rowan Cos., Inc. v. US*, 452 U.S. 247, 249 n.2, 101 S. Ct. 2288, 2290 n.2, 68 L. Ed. 2d 814 (1981). The employer and employee pay equal portions of this tax. IRC §§ 3101, 3111. The employee share of the tax is collected by the employer through deductions from the employee's wages. IRC § 3102.

10. FICA defines "wages" as "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash, "subject to certain exemptions not relevant here. IRC § 3121(a). The term "employment" is defined as "any service, of whatever nature, performed . . . by an employee for the person employing him." IRC § 3121(b).

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pursuant to Treas. Reg. § 31.6402(a)-2. The Debtors will make reasonable efforts to distribute the employee portion to the respective employee. If the Debtors are not able to now locate the employees, the Debtors will return those funds to the IRS.

[3] Pursuant to IRC § 6532, if the Internal Revenue service does not render a decision on a refund claim within six months, the taxpayer can file a refund suit for recovery of such refund. IRC § 6532.

11. Employers often provide supplemental unemployment compensation benefits (often referred to as "SUB-pay") to laid-off employees. Section 3402(*o*)(1)(A) of the IRC recognizes that SUB-pay, as defined by Section 3402(o)(2)(A) of the IRC, is not wages for income tax withholding purposes. IRC § 3402(*o*)(1)(A) and (2)(A); *see also* Treas. Reg. § 31.3401(a)-1,(b)(14). Recently, the Court of Federal Claims determined that the legislative history of IRC § 3402 supported a finding that SUB-pay is not "wages" for any tax purpose, and, therefore, may not be treated as if it was a "wage" for FICA purposes. *CSX Corporation v. U.S.*, 52 Fed. Cl. 208, 216 (Fed. Cl. 2002). A copy of *CSX Corporation* is attached hereto as *Exhibit A*.

12. Prior to filing Chapter 11 and as a result of merger overlap and a liquidity crisis, the Debtors were forced to close approximately 63 stores and 9 distribution centers. During the course of the bankruptcy cases, the Debtors closed their remaining 311 stores and 3 distribution centers. Therefore, over 4,000 full-time employees were involuntarily terminated during the time period of 1999 through 2002.

13. Pursuant to the Debtors' severance policy prior to the Involuntary Petition being filed on October 20, 2001, and thereafter pursuant to Bankruptcy Court orders approving the implementation of the key employee retention plan, during the time period of 1999 through 2002, the Debtors paid over $10 million in SUB-pay for the involuntary terminations to employees due to the impending closing of approximately 384 stores and 12 distribution centers nationwide, plus

the corporate office. Such payments were made only to full-time employees who did not have other employment already arranged at the time of their involuntary termination. (Part-time employees did not receive any such payment.)

14. The Debtors timely paid the employer portion of FICA taxes and submitted the deducted employee portion of FICA taxes for the SUB-pay.

15. Since that time, the Debtors have realized that they overpaid FICA taxes on the SUB-pay since no FICA taxes were due. Thus, on September 17, 2002, the Debtors filed 15 separate Form 843's (Claim for Refund and Request for Abatement) to recover $571,405 for the *employer* portion of FICA tax paid and $428,720 for the *employee* portion for employees who had consented to have the Debtors submit their individual claim for refund to the IRS. A copy of the From 843's are attached hereto and incorporated herein as *Exhibit B.*[4] Consequently, the Debtors requested a total of $1,000,125 plus interest from the IRS.

16. On October 22, 2002, the Debtors received a notice from the IRS stating that the IRS received the Debtors' claim for refund as to two (2) of the four (4) Debtor entities but that they had not "completed all processing necessary for a complete response." *See* Letters dated October 22, 2002 from IRS to two (2) Debtor entities, attached hereto and incorporated

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[4] On Exhibit B, the Debtors have redacted all social security numbers of former employees but the social security numbers were included in the original filing of the Form 843's.

herein as *Exhibit C*. The Debtors were directed to contact Ms. Maxine Fields at the IRS with further questions on the FICA Refund.

17. The Debtors contacted Ms. Fields in June of 2003. She stated that she did not know anything about the FICA Refund except for the fact that it was "in Ogden."[5] Ms. Fields instructed the Debtors to "call back later."

18. The Debtors contacted the IRS twice in 2004 via telephone. (By this time, Ms. Fields no longer worked for the IRS and the Debtors were directed elsewhere.) On January 3, 2005, and acting upon instructions from the IRS, the Debtors sent the IRS a letter asking for an update on the FICA Refund. Attached hereto and incorporated herein as *Exhibit D* is a copy of the January 3,2005 letter. The Debtors never received a response to the letter.

**Count I: Turnover of Tax Refund**

19. The Debtors hereby repeat and reallege each of the above paragraphs as though fully set forth herein.

20. Based upon the 15 Form 843's submitted to the IRS, the IRS is holding approximately $1,000,125 (plus interest) which is owed to the Debtors.

21. The Debtors' FICA Refund constitutes property of the Debtors' estates under Section 541 of the Bankruptcy Code, which is subject to turnover pur-

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[5] The Debtors presume she was referring to the IRS Service Center in Ogden, Utah.

suant to Section 542 of the Bankruptcy Code and Bankruptcy Rule 7001.

22. More than 120 days have passed since the Debtors properly requested the return of the Debtors FICA Refund and, pursuant to Section 505(a)(2)(B) of the Bankruptcy Code, the Bankruptcy Court may determine such refund liability.

23. The Debtors are entitled to entry of judgment in their favor, ordering the IRS to turnover the FICA Refund to the Debtors, plus an amount equal to the accrued interest thereon pursuant to IRC § 6611.

WHEREFORE, the Debtors respectfully request judgment in their favor and against the IRS:

(a) For $571,405.00, which constitutes the employer portion of the FICA Refund due to the Debtors;

(b) For $428,720.00, which constitutes the employee portion of the FICA Refund to be paid to the Debtors;

(c) For immediate turnover by IRS to the Debtors of the FICA Refund in the amount of $1,000,125.00, plus accrued interest consistent with IRC § 6611;

(d) For costs of suit incurred herein; and

(e) For such other and further relief as the Court may deem just and proper.

Dated: June 1, 2005

Respectfully,

KIRKLAND & ELLIS LLP

/s/ Rachel Reagler Schulman

Janet S. Baer
Rachel Reagler. Schulman
200 East Randolph Drive
Chicago, Illinois 60601
Tel: (312) 861-2000
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Counsel for the Debtors

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

---

No. GG-01-10662
Chapter 11
Jointly Administered

IN RE: QUALITY STORES, INC., ET AL.,[1] DEBTORS

---

Adversary No. 05-80573

QUALITY STORES, INC., ET AL., PLAINTIFF

*v.*

UNITED STATES OF AMERICA, DEFENDANT

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Filed: Aug. 15, 2006

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**JOINT STIPULATION OF UNDISPUTED FACTS**

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Honorable James D. Gregg.

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[1] The Debtors are the following entities: QSI Holdings, Inc. (f/k/a CT Holdings, Inc.); Quality Stores, Inc. (f/k/a Central Tractor Farm & Country, Inc.); Country General, Inc.; F and C Holding, Inc.; FarmandCountry.com, LLC; QSI Newco, Inc.; QSI Transportation, Inc.; Quality Farm & Fleet, Inc.; Quality Investments, Inc.; Quality Stores Services, Inc.; and Vision Transportation, Inc.

Pursuant to this Court's Second Pretrial Order dated April 20, 2006 setting forth a briefing schedule for motions for summary judgment, the parties to the above-captioned matter hereby submit this Joint Stipulation of Undisputed Facts (the "Stipulation"). Each of the parties reserves the right to object to the relevancy of any fact contained in the Stipulation and to present other and further evidence not inconsistent with the facts therein stated. The parties stipulate to the authenticity of the exhibits.

**The Parties**

1. Plaintiff Quality Stores, Inc. et al. ("Quality") consists of the post-confirmation estates of the Debtors, which were created on May 13, 2002 (the "Effective Date") pursuant to the Court's Order (the "Confirmation Order") confirming the First Amended Joint Plan of Reorganization (the "Plan").

2. On October 20, 2001, an involuntary petition was filed against the Debtors (the "Involuntary Petition") under Chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code"). On November 1, 2001, Quality Stores, Inc. answered the Involuntary Petition and consented to the entry of an order for relief, and the remaining Debtors commenced voluntary Chapter 11 cases before this Court (the "Petition Date").

3. From their respective petition dates until the Effective Date, the Debtors operated their business and managed their properties as debtors in possession pursuant to Sections 1107(a) and 1108 of the Bankruptcy Code.

4. Defendant is the United States of America ("Defendant" or "Government").

**Jurisdiction and Venue**

5. This Court has jurisdiction over this matter under 28 U.S.C. §§ 157 and 1334. This matter is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2). Venue of this matter is proper in this district pursuant to 28 U.S.C. §§ 1408 and 1409.

6. This adversary proceeding was commenced pursuant to Sections 541, 542 and 505 of the Bankruptcy Code and Rule 7001(1) of the Federal Rules of Bankruptcy Procedure.

**Procedural Background**

7. For the taxable quarters ending December 31, 1999 through June 30, 2002, the Debtors filed timely Forms 941 reporting wages paid to employees and remitting applicable Federal Insurance Contribution Act ("FICA") taxes.

8. On September 17, 2002, certain of the Debtors timely filed with the Internal Revenue Service ("IRS") 15 separate Forms 843 (Claim for Refund and Request for Abatement) (the "Refund Claims") to recover $1,000,125 of FICA tax for the taxable quarters ending December 31, 1999 through June 30, 2002, consisting of $571,127 of the employer share of FICA tax and $428,998 of the employee share of FICA tax.

9. The Debtors that filed the Forms 843 were Central Tractor Farm & Country Inc., Employer Identification Number ("EIN") 42-1425562 ("Central

Tractor"); Country General Inc., EIN 47-0778047 ("Country General"); Quality Farm & Fleet Inc., EIN 38-3244519 ("Quality Farm"); and Quality Stores Services, Inc., EIN 38-342930 ("Quality Stores").

10. Consistent with the requirements of Treas. Reg. § 31.6402(a)-2, the Debtors requested the consent of all employees potentially covered by the Refund Claims (approximately 3,100 employees) to file a refund claim for the employee share of FICA tax on their behalf. Only the employee share of FICA tax for employees who granted consent to the Debtors (approximately 1,850 employees) is included in the Refund Claims.

11. The IRS has not yet denied or allowed the Refund Claims.

**Nature of the Refund Claims**

12. Prior to the bankruptcy cases, the Debtors were the largest agricultural specialty retailer in the United States. The Debtors' stores served the needs of rural customers, specifically part-time and full-time farmers, hobby gardeners, skilled trade persons and do-it-yourself customers.

13. During the period prior to the Petition Date (the "Pre-Petition Period"), the Debtors were forced to close approximately 63 stores and nine distribution centers. The Debtors also terminated approximately 75 employees at their corporate office. After the Petition Date (the "Post-Petition Period"), the Debtors closed their remaining 311 stores and three distribution centers, and terminated the remaining corporate employees.

14. The Debtors made certain payments to employees who were involuntarily terminated during both the Pre-Petition Period and the Post-Petition Period (the "severance payments" or "severance pay").

15. The severance payments were paid to employees pursuant to a plan maintained by the Debtors, and were paid because of an employee's involuntary separation from employment, resulting directly from a reduction in force or the discontinuance of a plant or operation.

16. The severance payments were includible in the employees' gross income.

17. The Debtors reported the severance payments as wages on Forms W-2 issued to the employees. The Debtors withheld federal income tax, withheld the employees' share of FICA tax and paid the employer's share of FICA tax with respect to the severance payments.

18. The basis for the Refund Claims is the Debtors' position that the severance payments are not subject to FICA taxes because such payments constitute supplemental unemployment compensation benefits.

19. The severance plan that was in effect for the Pre-Petition Period is attached hereto as Exhibit A (the "Pre-Petition Severance Plan").

20. Under the terms of the Pre-Petition Severance Plan, senior executives received 12-18 months of severance pay and all other employees received one week of severance pay for each full year of service.

21. The severance payments under the Pre-Petition Severance Plan were (a) not tied to the receipt of state unemployment compensation and (b) not attributable to the rendering of any particular services.

22. The severance payments under the Pre-Petition Severance Plan were paid in accordance with the Debtors' normal payroll period (e.g., weekly or semi-weekly basis).

23. On average, salaried employees received 11.4 weeks of severance pay under the Pre-Petition Severance Plan, and hourly employees received 4.2 weeks of severance pay.

24. Of the total $1,000,125 FICA tax at issue in this case, approximately $382,362 is attributable to severance payments paid under the Pre-Petition Severance Plan, consisting of $214,000 of the employer share of FICA tax and $168,362 of the employee share of FICA tax.

25. A summary of the severance plan that was in existence for the Post-Petition Period is attached hereto as Exhibit B (the "Post-Petition Severance Plan"). The Post-Petition Severance Plan was approved by this Court.

26. Under the terms of the Post-Petition Severance Plan, officers received between six and 12 months of severance pay and full-time salaried and hourly employees who had been employed for at least two years received one week of severance pay for every full year of service, up to a maximum of 10 weeks for salaried employees and five weeks for hourly employ-

ees. Employees with less than two years of service received one week of severance pay. Employees who were immediately hired by any successor company (i.e., those companies that purchased the Debtors' assets) did not receive any severance pay.

27. The severance payments under the Post-Petition Severance Plan were (a) not tied to the receipt of state unemployment compensation and (b) not attributable to the rendering of any particular services.

28. The severance payments under the Post-Petition Severance Plan were paid in a lump sum, since the Debtors were in the process of liquidating and it was not administratively practicable to pay such amounts over time.

29. On average, salaried employees received 5.2 weeks of severance pay under the Post-Petition Severance Plan, and hourly employees received 3.1 weeks of severance pay.

30. Approximately 900 employees received no severance pay under the Post-Petition Severance Plan because they were hired by successor companies.

31. Of the total $1,000,125 FICA tax at issue in this case, approximately $617,763 is attributable to severance payments paid under the Post-Petition Severance Plan, consisting of $357,127 of the employer share of FICA tax and $260,636 of the employee share of FICA tax.

32. Employees were not required to prove they were unemployed in order to receive severance pay

under either the Pre-Petition Severance Plan or the Post-Petition Severance Plan.

33. The Debtors sent a letter to 200 of their former employees who received severance pay, which requested that the employees indicate whether or not they were unemployed after their termination and for how long. Eighty-six (86) employees responded, of whom 21 received severance pay under the Pre-Petition Severance Plan and 65 received severance pay under the Post-Petition Severance Plan. Seventy-one percent (71%) of the respondents who received severance pay under the Pre-Petition Severance Plan were unemployed for some period of time, for an average period of 23 weeks. Eighty-five percent (85%) of the respondents who received severance pay under the Post-Petition Severance Plan were unemployed for some period of time, for an average period of 18 weeks.

Respectfully submitted,

Dated: Aug. 15, 2006

KIRKLAND & ELLIS LLP

/s/ JANET S. BAER

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## EXHIBIT A

### Severance Policy and Procedures

**General Statement**

Quality Stores, Inc. intends to make salaried employees of the Company eligible for severance pay when their employment is to be terminated for reasons not personal to the individual. Such reasons might include

- a reduction in the level of business activity
- a reorganization
- the discontinuance or sale of a functional unit
- another business reason or condition as determined by Company officials

No person who, through his or her own action, severs the employment relationship, is eligible for severance pay under this policy. No person whose employment is severed for reasons personal to the employee, as determined by Company officials, is eligible for severance pay under this policy.

**Implementation**

1. Severance pay is based upon job grade and management level in the organization.
2. Company officers are responsible for determining when separations are to be made; how many personnel will be affected, and who the affected personnel will be.

3. The Vice President, Human Resources, is to review all separation situations which may involve severance payments or benefits. The President must approve all such situations. The Vice President, Human Resources, should normally be given advance notice of any separation plans which may call for application of this policy.

4. If the Company, in its discretion, offers and affected employee a different assignment in lieu of severance and the employee declines such reassignment, that individual will not be eligible for severance payments under this policy

5. Severance payments will either be made on a regular pay period basis or in a lump sum (at the discretion of the Company).

6. The benefits provided under this policy will be in addition to any earned but unused vacation pay to which the individual may be entitled. For purposes of "COBRA" health continuation rights, the "qualifying event" will be the date of severance of employment.

**Schedule of Severance Payments**

**President and CEO**

Eighteen (18) months of severance pay. A "month's pay" shall be computed by dividing the base salary at time of severance by twelve (12).

**Senior Management Executive Committee Member/ Vice President/Management Team Level** (A senior manager/vice president must have a minimum of one (1) year of service to qualify.)

Twelve (12) months of severance pay. A "month's pay" shall be computed by dividing the annual base salary at the time of severance by twelve (12).

**Director, Managers, Supervisors and Other Salaried Personnel**

One (1) week of severance pay for each full year of Company Service. (For example, 10 full years of service = 10 weeks of severance pay.) A "week's pay" shall be computed by dividing the annual base salary in effect at the time of severance by fifty-two (52).

**Hourly Personnel** (Severance eligibility for hourly personnel will be determined by Company officials.)

Severance payments will be based on amount of Company service. One (1) week of severance pay for each full year of Company service. (For example, 10 full years of service = 10 weeks of severance pay.)

**Disclaimer**

Quality Stores, Inc. is committed to reviewing all of its policies, including this policy, on a continuous basis, and reserves the right to modify, revoke, suspend, terminate or change any or all of its plans or policies, including this policy, at any time with or without notice. Accordingly, this policy is not a condition of employment. This policy is not intended to create, nor is it to be construed to constitute, a term or condition of employment or part of any "contract" of em-

ployment between Quality Stores, Inc. and any one or all of its employees.

**EXHIBIT B**

**Quality Stores, Inc.**
**Modified Severance Plan**

This plan is designed to assure employees that if their jobs are eliminated they will receive severance pay in consideration of deferring their job searches and dedicating their efforts and attention to the company. In order to be eligible to receive compensation under the severance plan, an employee must complete their last day of service as scheduled by the company. If the employee is offered comparable employment by new ownership, resigns, or is terminated for cause, he/she will not be eligible for severance pay. However, if the offer of employment from the new owner is contingent upon relocation, and the offer is declined the employee will be eligible for severance pay.

For Full Time Salaried Team Members

- ✓ Employees with less than two years of service will receive one week of severance
- ✓ Employees with service of two years or greater will receive one week of severance pay for every one full year of service to maximum of ten weeks of severance pay.

For Full Time Hourly Team Members

- ✓ Employees with less than two years of service will receive one week of severance
- ✓ Employees with service of two years or greater will receive one week of severance pay for every one full year of service to maximum of five weeks of severance pay.

# PETITIONER'S BRIEF

RECORD
AND
BRIEFS

NOV 8 - 2013

No. 12-1408

# In the Supreme Court of the United States

UNITED STATES OF AMERICA, PETITIONER

*v.*

QUALITY STORES, INC., ET AL.

*ON WRIT OF CERTIORARI*
*TO THE UNITED STATES COURT OF APPEALS*
*FOR THE SIXTH CIRCUIT*

## BRIEF FOR THE PETITIONER

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## QUESTION PRESENTED

Whether severance payments made to employees whose employment was involuntarily terminated are taxable under the Federal Insurance Contributions Act, 26 U.S.C. 3101 *et seq.*

## PARTIES TO THE PROCEEDING

Petitioner is the United States of America. Respondents are Quality Stores, Inc. (f/k/a Central Tractor Farm & Country, Inc.); QSI Holdings, Inc. (f/k/a CT Holdings, Inc.); Country General, Inc.; F and C Holding, Inc.; FarmandCountry.com, LLC; QSI Newco, Inc.; QSI Transportation, Inc.; Quality Farm & Fleet, Inc.; Quality Investments, Inc.; Quality Stores Services, Inc.; and Vision Transportation, Inc.

## TABLE OF CONTENTS


Page

Opinions below ..... 1
Jurisdiction ..... 1
Statutory and regulatory provisions involved ..... 2
Statement ..... 2
Summary of argument ..... 7
Argument:
Respondents' severance payments are covered by FICA ..... 10
A. FICA's expansive definition of "wages" encompasses severance payments like respondents' ..... 10
B. The court of appeals erred in construing 26 U.S.C. 3402(*o*), which is a substantive rule for income-tax withholding, to implicitly narrow FICA's definition of "wages" ..... 21
1. Section 3402(*o*) has no bearing on FICA's definitional provisions ..... 21
2. Payments covered by 26 U.S.C. 3402(*o*)(2)(A) can also be "wages" ..... 27
Conclusion ..... 37
Appendix — Statutory provisions ..... 1a


## TABLE OF AUTHORITIES

Cases:


*Accardi* v. *Pennsylvania R.R. Co.*, 383 U.S. 225 (1966) ..... 19
*American Bank & Trust Co.* v. *Dallas Cnty.*, 463 U.S. 855 (1983) ..... 15
*Bruesewitz* v. *Wyeth LLC*, 131 S. Ct. 1068 (2011) ..... 25
*CSX Corp.* v. *United States*, 518 F.3d 1328 (Fed. Cir. 2008) ..... 7, 17, 24, 27, 31, 34
*Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837 (1984) ..... 11
*Coffy* v. *Republic Steel Corp.*, 447 U.S. 191 (1980) ..... 18, 19

Cases—Continued: Page

*Environmental Def.* v. *Duke Energy Corp.*, 549 U.S. 561 (2007) ..... 26
*Florida Dep't of Revenue* v. *Picadilly Cafeterias, Inc.*, 554 U.S. 33 (2008) ..... 28
*Hillman* v. *Maretta*, 133 S. Ct. 1943 (2013) ..... 15
*John Wiley & Sons, Inc.* v. *Livingston*, 376 U.S. 543 (1964) ..... 12
*Mayo Found. for Med. Educ. & Research* v. *United States*, 131 S. Ct. 704 (2011) ..... 2, 3, 11
*Otte* v. *United States*, 419 U.S. 43 (1974) ..... 13
*Rowan Cos.* v. *United States*, 452 U.S. 247 (1981) ..... 15, 25, 26
*Social Sec. Bd.* v. *Nierotko*, 327 U.S. 358 (1946) ..... *passim*
*Stone* v. *INS*, 514 U.S. 386 (1995) ..... 20
*United States* v. *Cleveland Indians Baseball Co.*, 532 U.S. 200 (2001) ..... 2
*United States* v. *Lee*, 455 U.S. 252 (1982) ..... 14
*United States* v. *Silk*, 331 U.S. 704 (1947) ..... 2, 3, 15
*United States* v. *Wells Fargo Bank*, 485 U.S. 351 (1988) ..... 36

Statutes and regulations:

Act of July 14, 1960, Pub. L. No. 86-667, § 1, 74 Stat. 534 ..... 31, 33
Federal Insurance Contributions Act, 26 U.S.C. 3101 *et seq.* ..... 2
26 U.S.C. 3101(a) ..... 2, 10
26 U.S.C. 3101(b) ..... 2, 10
26 U.S.C. 3111(a) ..... 2, 10
26 U.S.C. 3111(b) ..... 2, 10
26 U.S.C. 3121(a) (1964) ..... 24

Statutes and regulations—Continued: Page

26 U.S.C. 3121(a) ..... *passim*, 1a
26 U.S.C. 3121(a)(1)-(23) ..... 14
26 U.S.C. 3121(a)(13) ..... 15
26 U.S.C. 3121(a)(13)(A) ..... 15
26 U.S.C. 3121(b) ..... 3, 8, 10, 1a
26 U.S.C. 3121(b)(1)-(21) ..... 14
Internal Revenue Code of 1954, ch. 21, 68A Stat. 417 (26 U.S.C. 3121(a)(3) (1958)) ..... 20
Social Security Act, ch. 531, 49 Stat. 636 (1935) ..... 15
§ 811(a), 49 Stat. 639 ..... 15
§ 811(b), 49 Stat. 639 ..... 16
Social Security Act Amendments of 1939, ch. 666, § 606, 53 Stat. 1383-1384 (codified at 26 U.S.C. 426(a)(4) (1940)) ..... 3, 16
Social Security Act Amendments of 1950, ch. 809, § 203(a), 64 Stat. 525-527 ..... 3, 16
Social Security Amendments of 1983, Pub. L. No. 98-21, Tit. III, § 324(a)(3)(B), 97 Stat. 123 ..... 20
Tax Reform Act of 1969, Pub. L. No. 91-172, § 805(g), 83 Stat. 708 ..... 24, 33
Vietnam Era Veterans' Readjustment Assistance Act of 1974, Pub. L. No. 93-508, 88 Stat. 1074 ..... 18
26 U.S.C. 501(c)(17) ..... 31, 33
26 U.S.C. 501(c)(17)(D) ..... 31
26 U.S.C. 501(c)(17)(D)(i) ..... 33
26 U.S.C. 3401 ..... 24
26 U.S.C. 3401(a) ..... 6, 21, 2a
26 U.S.C. 3401(a)(2) ..... 6, 21
26 U.S.C. 3401(b) ..... 24
26 U.S.C. 3402(a)(1) ..... 6, 21, 2a
26 U.S.C. 3402(a)(2) ..... 24

Statutes and regulations—Continued: Page

26 U.S.C. 3402(b) ..... 24
26 U.S.C. 3402(c) ..... 24
26 U.S.C. 3402(h)(2)-(4) ..... 24
26 U.S.C. 3402(*o*) ..... *passim*, 3a
26 U.S.C. 3402(*o*)(1) ..... 7, 23, 24, 3a
26 U.S.C. 3402(*o*)(1)(A) ..... 6, 22, 3a
26 U.S.C. 3402(*o*)(2)(A) ..... *passim*, 3a
42 U.S.C. 401 *et seq.* ..... 2
20 C.F.R. 404.1001 ..... 2
26 C.F.R.
Section 31.3121(a)-1(b) ..... 13
Section 31.3121(a)-1(c) ..... 12
Section 31.3121(a)-1(c)-(e) ..... 11
Section 31.3121(a)-1(i) ..... 13
Section 31.3121(a)-1(j) ..... 14
Section 31.3121(a)(3)-1 ..... 20
Section 31.3121(b)-3(b) ..... 13
Section 31.3401(a)-1(b)(4) (1968) ..... 36
Section 601.601(d)(2) ..... 17

Miscellaneous:

*Black's Law Dictionary* (9th ed. 2009) ..... 10
Bureau of Internal Revenue, *Employees' Tax and the Employers' Tax Under Title VIII of the Social Security Act*, 1 Fed. Reg. 1764 (Nov. 11, 1936) ..... 16
H.R. Conf. Rep. No. 1145, 86th Cong., 1st Sess. (1959) ..... 31
H.R. Rep. No. 1300, 81st Cong., 1st Sess. (1949) ..... 3, 8, 17
H.R. Rep. No. 25, 98th Cong., 1st Sess. (1983) ..... 20
I.R.S. Tech. Adv. Mem. 94-16-003 (Apr. 22, 1994) ..... 29

Miscellaneous—Continued: Page

Note, *Unemployment Insurance: Supplemental Unemployment Benefit Plans*, 1962 Duke L.J. 605 ..... 29
Rev. Rul. 56-249, 1956-1 C.B. 488 ..... 30, 33
Rev. Rul. 58-128, 1958-1 C.B. 89 ..... 30, 33
Rev. Rul. 60-330, 1960-2 C.B. 46 ..... 30, 32, 33
Rev. Rul. 65-251, 1965-2 C.B. 395 ..... 32, 33
Rev. Rul. 71-408, 1971-2 C.B. 340 ..... 34
Rev. Rul. 77-347, 1977-2 C.B. 362 ..... 30, 34
Rev. Rul. 90-72, 1990-2 C.B. 211 ..... 8, 17, 30, 34
S. Rep. No. 1518, 86th Cong., 2d. Sess. (1960) ..... 31
S. Rep. No. 552, 91st Cong., 1st Sess. (1969) ..... 25, 32
Stewart J. Schwab & Randall S. Thomas, *An Empirical Analysis of CEO Employment Contracts: What Do Top Executives Bargain For?*, 63 Wash. & Lee L. Rev. 231 (2006) ..... 12
*Statements and Recommendations of the Department of the Treasury: Hearings on H.R. 13270 Before the Senate Comm. on Finance*, 91st Cong., 1st Sess. (1969) ..... 32
Subcomm. On Social Sec., 80th Cong., Rep. on Social Sec. Amendments (Comm. Print 1948) ..... 17
8 *The Oxford English Dictionary* (1st ed. 1933) ..... 11
*Webster's Third New International Dictionary of the English Language* (1993) ..... 10

# In the Supreme Court of the United States

No. 12-1408

UNITED STATES OF AMERICA, PETITIONER

*v.*

QUALITY STORES, INC., ET AL.

*ON WRIT OF CERTIORARI*
*TO THE UNITED STATES COURT OF APPEALS*
*FOR THE SIXTH CIRCUIT*

## BRIEF FOR THE PETITIONER

### OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-30a) is reported at 693 F.3d 605. The opinion of the district court (Pet. App. 33a-54a) is reported at 424 B.R. 237. The opinion of the bankruptcy court (Pet. App. 55a-77a) is reported at 383 B.R. 67.

### JURISDICTION

The judgment of the court of appeals was entered on September 7, 2012. A petition for rehearing was denied on January 4, 2013 (Pet. App. 31a-32a). On March 25, 2013, the Chief Justice extended the time within which to file a petition for a writ of certiorari to and including May 3, 2013. On April 22, 2013, the Chief Justice further extended the time to May 31, 2013, and the petition was filed on that date. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

## STATUTORY AND REGULATORY PROVISIONS INVOLVED

Pertinent portions of 26 U.S.C. 3121(a)-(b), 3401, and 3402 are reproduced in the appendix to this brief. App., *infra*, 1a-4a. Other relevant statutory and regulatory provisions are reproduced in the appendix to the petition for a writ of certiorari. Pet. App. 84a-214a.

## STATEMENT

1. The Social Security Act and related legislation establish "a comprehensive national insurance system that provides benefits for retired workers, disabled workers, unemployed workers, and their families." *Mayo Found. for Med. Educ. & Research* v. *United States*, 131 S. Ct. 704, 709 (2011). Those benefits are funded through taxes collected under the Federal Insurance Contributions Act (FICA), 26 U.S.C. 3101 *et seq.* See *Mayo Found.*, 131 S. Ct. at 709. FICA taxes are imposed on both employers and employees, and both elements of the tax are imposed on "wages" paid by an employer or received by an employee "with respect to employment." 26 U.S.C. 3101(a) and (b), 3111(a) and (b). An employee who pays taxes on "wages" under FICA generally accrues corresponding wage credits, which increase the amount of FICA-financed benefits to which he is entitled. See 42 U.S.C. 401 *et seq.*; see also 20 C.F.R. 404.1001; *United States* v. *Cleveland Indians Baseball Co.*, 532 U.S. 200, 212-213 (2001); *United States* v. *Silk*, 331 U.S. 704, 711 (1947).

Consistent with the broad remedial purposes of the Social Security program, the terms that define FICA's scope "import a breadth of coverage." *Mayo Found.*, 131 S. Ct. at 715 (citation omitted); see, *e.g.*, *Social*

*Sec. Bd.* v. *Nierotko*, 327 U.S. 358, 365 (1946); *Silk*, 331 U.S. at 711-712. In particular, "Congress has defined 'wages' broadly, to encompass 'all remuneration for employment.'" *Mayo Found.*, 131 S. Ct. at 709 (quoting 26 U.S.C. 3121(a)). "The term 'employment' has a similarly broad reach, extending to 'any service, of whatever nature, performed . . . by an employee for the person employing him.'" *Ibid.* (quoting 26 U.S.C. 3121(b)). This Court has explained in a related context that "'service' as used by Congress in this definitive phrase means not only work actually done but the entire employer-employee relationship for which compensation is paid to the employee by the employer." *Nierotko*, 327 U.S. at 365-366.

A predecessor to the current version of FICA specifically "except[ed]" from the basic definition of "wages" any "[d]ismissal payments which the employer [was] not legally required to make." Social Security Act Amendments of 1939 (1939 Social Security Amendments), ch. 666, § 606, 53 Stat. 1383-1384 (codified at 26 U.S.C. 1426(a)(4) (1940)). In 1950, however, Congress eliminated that exception. See Social Security Act Amendments of 1950 (1950 Social Security Amendments), ch. 809, § 203(a), 64 Stat. 525-527. The House Committee Report accompanying the bill explained that, in the absence of the exception, so long as an employee had not already earned the maximum amount of taxable "wages" for a particular year, "any payment made by an employer on account of involuntary separation of the employee from the service of the employer, will constitute wages." H.R. Rep. No. 1300, 81st Cong., 1st Sess. 124 (1949) (1949 House Report).

2. Respondents are an agricultural-specialty retailer and several affiliated companies that entered into bankruptcy proceedings in 2001. Pet. App. 2a. Both before and after the filing of a bankruptcy petition, respondents terminated thousands of their employees. *Id.* at 3a, 5a. Those employees received severance payments from respondents pursuant to two separate plans. *Id.* at 3a-4a.

Under the terms of the pre-petition severance plan, any employee who was terminated for general business reasons (like the closing of a store or a plant) received severance pay based on his job grade and management level in the organization. Pet. App. 3a; see J.A. 56. The president and chief executive officer received 18 months of severance pay; senior management executives received 12 months of severance pay; and other managers and employees received one week of severance pay for each full year of service. Pet. App. 3a; see J.A. 57-58. For each employee, the amount of the severance pay was equal to the employee's regular salary for the covered period, and respondents made the severance payments on their normal payroll schedule. Pet. App. 3a-4a; J.A. 57-58. Under the pre-petition plan, salaried employees received an average of 11.4 weeks of severance pay, while hourly employees received an average of 4.2 weeks of severance pay. Pet. App. 4a; J.A. 52.

The post-petition severance plan was designed to encourage remaining employees to defer their job searches and to dedicate their time and efforts to respondents' post-bankruptcy operations. Pet. App. 4a. To be eligible for severance pay under the post-petition plan, an employee was required to complete his last day of service as scheduled by respondents.

*Ibid.*; J.A. 60. For those employees who did so, executives received between six and 12 months of severance pay; full-time salaried and hourly employees who had been employed for at least two years received one week of severance pay for every full year of service (up to a maximum of ten weeks for salaried employees and five weeks for hourly employees); and salaried and hourly employees with less than two years of service received one week of severance pay. Pet. App. 4a; J.A. 52-53, 60. Each of these post-petition severance amounts was paid as a lump sum at the end of an employee's service. Pet. App. 4a. Under the post-petition plan, salaried employees received an average of 5.2 weeks of severance pay, while hourly employees received an average of 3.1 weeks of severance pay. *Ibid.*; J.A. 53.

Respondents reported the severance payments as wages on W-2 forms and withheld federal income tax. Pet. App. 5a. Respondents also remitted to the Internal Revenue Service (IRS) a percentage of the severance payments to account for both employer and employee FICA taxes. *Ibid.* Subsequently, however, respondents filed for a refund of $1,000,125 in FICA tax that they had paid as employers and that they had paid on behalf of roughly 1850 employees. *Id.* at 5a-6a. When the IRS did not allow or deny the claim, respondents filed an adversary proceeding in the bankruptcy court seeking a refund of the disputed amount. *Id.* at 6a.

3. The bankruptcy court granted summary judgment to respondents, Pet. App. 55a-77a, and the district court affirmed, *id.* at 33a-54a. The court of appeals also affirmed. *Id.* at 1a-30a.

The court of appeals' analysis, like the analyses of the district court and the bankruptcy court, focused largely on a provision, 26 U.S.C. 3402(*o*), that is not part of FICA, but instead concerns withholding of income tax. Pet. App. 8a-30a; *id.* at 43a-54a, 60a-77a. Chapter 24 of the Internal Revenue Code contains a definition of "wages" substantially similar to FICA's, see 26 U.S.C. 3401(a), and it generally requires that "every employer making payment of wages * * * deduct and withhold" income tax from those "wages," 26 U.S.C. 3402(a)(1). Section 3402(*o*), entitled "[e]xtension of withholding to certain payments other than wages," states a "[g]eneral rule" that, for purposes of Chapter 24 (and certain procedural provisions) "any supplemental unemployment compensation benefit paid to an individual * * * shall be treated as if it were a payment of wages by an employer to an employee for a payroll period." 26 U.S.C. 3402(*o*)(1)(A). The term "[s]upplemental unemployment compensation benefits" is defined to mean "amounts which are paid to an employee, pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment (whether or not such separation is temporary), resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, but only to the extent such benefits are includible in the employee's gross income." 26 U.S.C. 3402(*o*)(2)(A).

Based on the parties' stipulation of certain facts,[1] the court of appeals concluded that respondents' sev-

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[1] The parties stipulated that the severance payments at issue in this case "were paid because of" the employees' "involuntary separation from employment, resulting directly from a reduction in force or the discontinuance of a plant or operation"; were "not tied

erance payments fell within Section 3402(*o*)(2)(A)'s definition of "supplemental unemployment compensation benefits." Pet. App. 11a. The court also observed that, under Section 3402(*o*)(1), any payment that falls within that statutory definition "shall be treated *as if it were a payment of wages* by an employer to an employee for a payroll period." *Ibid.* (quoting 26 U.S.C. 3402(*o*)(1)) (emphasis added by court of appeals). The court of appeals found that the "necessary implication" of the italicized language was "that Congress did not consider [such] payments to be 'wages,' but allowed their treatment as wages to facilitate federal income tax withholding." *Id.* at 11a-12a (quoting 26 U.S.C. 3402(*o*)(1)). The court further reasoned that, if "supplemental unemployment compensation benefits" are "not 'wages' but are only treated as if they were 'wages' for purposes of federal income tax withholding, then [such] payments also are not 'wages' under the nearly identical definition of that term found in the FICA statute." *Id.* at 13a-14a. The court of appeals recognized that its decision conflicted with the Federal Circuit's decision in *CSX Corp.* v. *United States*, 518 F.3d 1328 (2008), which had rejected the proposition that "all payments that qualify * * * under the statutory definition in section 3402(*o*)(2)(A) are non-wages for purposes of FICA." *Id.* at 1345; see Pet. App. 20a.

## SUMMARY OF ARGUMENT

FICA broadly defines the term "wages" as all remuneration received for any service by an employee.

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to the receipt of state unemployment compensation"; and were "not attributable to the rendering of any particular services" by the employees to respondents. J.A. 51-53.

See 26 U.S.C. 3121(a) and (b). The severance payments at issue in this case fit comfortably within that broad definition, which encompasses "the entire employer-employee relationship for which compensation is paid to the employee by the employer." *Social Sec. Bd.* v. *Nierotko*, 327 U.S. 358, 366 (1946). Respondents' severance payments constituted a final reward for the recipients' service as employees, and they were calculated by reference to individual employees' positions, length of service, and former salaries.

None of the statutory exceptions to FICA's expansive definition of "wages" is applicable here. Congress's deliberate decision to eliminate an exception for certain types of "dismissal payments," which had appeared in a previous version of the statute, reinforces the conclusion that "any payment made by an employer on account of involuntary separation of the employee from the service of the employer, will constitute wages." 1949 House Report 124. Respondents' severance payments also do not fall within the limited administrative exception to the statutory definition of "wages" that the IRS has carved out in a series of Revenue Rulings. See, *e.g.*, Rev. Rul. 90-72, 1990-2 C.B. 211. Rather, respondents' payments, like other types of separation-related payments, fall within FICA's basic definition of "wages," which includes all compensation based upon and arising out of the employer-employee relationship.

The court of appeals erred in construing 26 U.S.C. 3402(*o*) to require a considerably narrower construction of FICA's definition of "wages." Section 3402(*o*) is not part of FICA, but is instead an income-tax-withholding rule that requires certain types of em-

ployer-sponsored unemployment benefits to be "treated as * * * wages" for withholding purposes. Because Section 3402(*o*) applies only to the income-tax withholding context (and related procedural provisions), it cannot supersede the definitional provisions in FICA.

Even in the income-tax-withholding context, Section 3402(*o*) does not narrow the definition of "wages." Congress enacted Section 3402(*o*) following a series of administrative decisions in which the IRS had excepted certain subtypes of employer-sponsored unemployment benefits from the statutory definition of "wages" for employment-tax and withholding purposes. The provision directs that certain unemployment-benefit payments will be "treated" as "wages" for withholding purposes, *whether or not* they would otherwise be so regarded, in order to ensure that recipients will not face large income-tax liability at the end of the year. The provision does not logically imply, however, that *none* of the payments covered by the statutory definition of "supplemental unemployment compensation benefits" would otherwise qualify as "wages." The construction of Section 3402(*o*) advanced by the court of appeals and respondents has no sound basis in the provision's text or history, and it cannot justify excepting respondents' severance payments from the broad reach of FICA.

## ARGUMENT

### RESPONDENTS' SEVERANCE PAYMENTS ARE COVERED BY FICA

#### A. FICA's Expansive Definition Of "Wages" Encompasses Severance Payments Like Respondents'

To fund the Social Security and Medicare programs, FICA requires employers and employees to pay taxes on all "wages" paid by an employer or received by an employee "with respect to employment." 26 U.S.C. 3101(a) and (b); 26 U.S.C. 3111(a) and (b). FICA's expansive definitions of the relevant terms "import a breadth of coverage," *Mayo Found. for Med. Educ. & Research* v. *United States*, 131 S. Ct. 704, 715 (2011) (citation omitted), that readily encompasses the severance payments at issue here.

1. FICA defines the terms "wages" and "employment" in sweeping language. The basic definition of "wages" includes "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash." 26 U.S.C. 3121(a). The basic definition of "employment" includes "any service, of whatever nature, performed * * * by an employee for the person employing him." 26 U.S.C. 3121(b).

The severance payments at issue here fit squarely within those definitions. Those payments were undoubtedly a form of "remuneration." That term has long been understood as effectively synonymous with payment or compensation. See, *e.g.*, *Black's Law Dictionary* 1409 (9th ed. 2009) (defining "remuneration" as "[p]ayment; compensation"); *Webster's Third New International Dictionary of the English Language* 1921 (1993) (defining "remunerate" as "to pay an equivalent to (a person) for a service, loss, or ex-

pense: recompense, compensate") (capitalization omitted); 8 *The Oxford English Dictionary* 439 (1st ed. 1933) (defining "[r]emuneration" as "[r]eward, recompense, repayment; payment, pay"). The current Treasury regulations—which are entitled to deference under *Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837, 843 (1984)), see *Mayo Found.*, 131 S. Ct. at 713—underscore the breadth of the term. Those regulations provide that a payment can constitute "remuneration" regardless of the "name by which [it] is designated," "the basis upon which [it] is paid," or "the medium in which [it] is paid." 26 C.F.R. 31.3121(a)-1(c)-(e). That expansive definition is consistent with this Court's decision in *Social Security Board* v. *Nierotko*, 327 U.S. 358 (1946), which held that an administrative award of back pay to a wrongfully discharged employee was "[s]urely * * * 'remuneration'" within the meaning of a Social Security benefits provision that defined "wages" in the same manner as FICA. *Id.* at 364; see *id.* at 362-363.

The severance payments in this case were also made in return for a "service, of whatever nature, performed" by the recipients. In concluding that the back-pay award in *Nierotko* constituted "wages," this Court explained that "'service' as used by Congress in this definitive phrase means not only work actually done but the entire employer-employee relationship for which compensation is paid to the employee by the employer." 327 U.S. at 365-366. Accordingly, by defining "employment" expansively to include "any service, of whatever nature," FICA encompasses not only compensation for an employee's performance of specific functions, but also compensation that accounts more generally for an employee's entire performance

over a period of time. That would include severance payments, which function as a parting reward for an employee's entire body of work on the employer's behalf.

As an incident of employment, severance payments are analogous to other types of payments, such as benefits (*e.g.*, vacation pay) or bonuses (*e.g.*, holiday bonuses), that would qualify as "wages" even if not tied to a specific service by the employee. See 26 U.S.C. 3121(a) (including "benefits" in the definition of "wages"); 26 C.F.R. 31.3121(a)-1(c) (recognizing that "bonuses * * * are wages if paid as compensation for employment"). Indeed, severance payments could be considered a form of benefit or bonus, paid in consideration for an employee's term of service. Like other sorts of benefits and bonuses, severance payments are commonly (but not always) negotiated in advance as part of the original contract that defines the "employer-employee relationship." See, *e.g.*, *John Wiley & Sons, Inc.* v. *Livingston*, 376 U.S. 543, 545 (1964) (describing "severance pay" as a "matter[] typically covered by collective bargaining agreements"); Stewart J. Schwab & Randall S. Thomas, *An Empirical Analysis of CEO Employment Contracts: What Do Top Executives Bargain For?*, 63 Wash. & Lee L. Rev. 231, 236, 239 (2006) (explaining that severance packages are often part of top executives' contracts).

The link between severance payments and prior service is especially clear in the circumstances of this case. Respondents' severance plans provided for payments only to individuals who had been respondents' employees (and thus had performed services on respondents' behalf), and the terms of the payments were tied to particular aspects of the individual em-

ployment relationships. Pet. App. 3a-4a. The plans calculated payment amounts by reference to the positions the recipients had held within respondents' work force, the length of time they had worked for respondents, and the salaries they had earned during their periods of service. *Ibid.*; J.A. 56-60. The post-petition plan was designed specifically to compensate employees for performing additional services after respondents entered into bankruptcy, thereby providing those employees with an incentive to defer their job searches and dedicate their time and efforts to their current employers. Pet. App. 4a; J.A. 60.

It is irrelevant for FICA purposes that payments in this case were made only after the recipients' employment with respondents had ended. Payments may be "wages" under FICA "even though * * * at the time of payment, the employment relationship * * * no longer exists." *Otte* v. *United States*, 419 U.S. 43, 51 (1974). That understanding of the statute has "long and consistently" been reflected in the regulations implementing FICA. *Ibid.* Those regulations continue to provide that a payment does not lose its character as "[r]emuneration for employment" merely because "at the time paid the relationship of employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them." 26 C.F.R. 31.3121(a)-1(i). Severance payments therefore satisfy FICA's definition of "wages" irrespective of when the separated employee actually receives the compensation.

2. Payments that meet the basic statutory definition of "wages" are covered by FICA "unless specifically excepted." 26 C.F.R. 31.3121(a)-1(b); see 26

C.F.R. 31.3121(b)-3(b) (same for "employment"). FICA identifies particular types of remuneration that do not constitute "wages," see 26 U.S.C. 3121(a)(1)-(23), and particular types of services that do not constitute "employment," see 26 U.S.C. 3121(b)(1)-(21). See also 26 C.F.R. 31.3121(a)-1(j) (regulatory exceptions to definition of "wages"). Respondents have not contended, and the court of appeals did not hold, that the severance payments at issue here fit within any of those exceptions.

This Court has recognized, in addressing a predecessor to FICA, that "[t]he very specificity of [its] exemptions" provides an additional reason for construing the basic definitional provisions broadly. *United States* v. *Silk*, 331 U.S. 704, 711-712 (1947). In order to assure adequate funding for the social-welfare programs that are financed by taxes on "wages," Congress has enacted expansive default definitions of "wages" and "employment." See *ibid.* (observing that "the generality of the employment definitions indicates that the terms 'employment' and 'employee,' are to be construed to accomplish the purposes of the legislation") (footnote omitted). Congress has also carefully considered and precisely delineated specific exemptions for types of payments and activities it did not want to cover. See *ibid.*; see also, *e.g.*, *United States* v. *Lee*, 455 U.S. 252, 260-261 (1982) (recognizing that the "narrow" scope of a particular exemption applicable to FICA reflected congressional balancing of interests). This Court has accordingly cautioned against adopting "a constricted interpretation" of FICA's default definitional provisions, which would "make for a continuance, to a considerable degree, of the difficulties" that the "federal social security legis-

lation" was designed to "remedy," and "would invite adroit schemes by some employers and employees to avoid the immediate burdens at the expense of the benefits sought by the legislation." *Silk*, 331 U.S. at 712.

Not only the existence, but also the substance, of the specific exceptions in Section 3121(a) supports the conclusion that the severance payments at issue here are "wages." Section 3121(a)(13) excludes from the statutory definition of "wages" a limited subset of termination-related payments, namely, certain types of disability payments made "upon or after the termination of an employee's employment relationship because of * * * retirement for disability." 26 U.S.C. 3121(a)(13)(A). Such an exception would have been unnecessary if the basic definition of "wages" did not cover termination-related payments at all. See *Hillman* v. *Maretta*, 133 S. Ct. 1943, 1953 (2013) (considering Congress's enactment of a "limited exception" to a statutory rule as evidence that Congress did not intend a broader exception); *American Bank & Trust Co.* v. *Dallas Cnty.*, 463 U.S. 855, 863-864 (1983) (considering a provision's broad scope to be "reinforce[d]" by statutory exceptions that would be "superfluous" if the provision was given a narrower interpretation).

3. The history of FICA confirms Congress's intent that severance payments like respondents' be included in the definition of "wages." FICA has its origins in Title VIII of the Social Security Act, ch. 531, 49 Stat. 636 (1935). *Rowan Cos.* v. *United States*, 452 U.S. 247, 255 (1981). The 1935 Act's basic definitions of "wages" and "employment" were substantially the same as the ones in the current version of FICA. See § 811(a), 49

Stat. 639 ("The term 'wages' means all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash."); § 811(b), 49 Stat. 639 ("The term 'employment' means any service, of whatever nature, performed within the United States by an employee for his employer."). Shortly after those provisions were enacted, the Treasury Department issued regulations providing that the statutory definition of "wages" included "dismissal pay." Bureau of Internal Revenue, *Employees' Tax and the Employers' Tax Under Title VIII of the Social Security Act*, 1 Fed. Reg. 1764, 1769 (Nov. 11, 1936).

In 1939, Congress amended the relevant definitional sections. See 1939 Social Security Amendments § 606, 53 Stat. 1383-1384. Although the basic definitions of "wages" and "employment" remained substantially unchanged, *ibid.*, the 1939 amendments excepted "[d]ismissal payments which the employer is not legally required to make" from the statutory definition of "wages," *id.* at 1384 (codified at 26 U.S.C. 1426(a)(4) (1940)). While that statutory exception was in effect, severance payments like those provided under respondents' pre-petition plan presumably would not have been covered by FICA.

In 1950, however, Congress repealed the exception for discretionary dismissal payments, and no such exception appears in the current version of the statute. See 26 U.S.C. 3121(a); 1950 Social Security Amendments, ch. 809, § 203(a), 64 Stat. 525-527. The subcommittee report recommending the change explained that eliminating the distinction between discretionary and required dismissal payments would "reduce the amount of record keeping required for

employers" and "remove the difficulties of deciding whether dismissal payments are taxable or nontaxable under present law." Subcomm. on Social Sec., 80th Cong., Rep. on Social Sec. Amendments 13 (Comm. Print 1948). The report further explained that "[d]ismissal payments assume a wide variety of forms," including "amounts paid because of involuntary employment termination, even where they represent payments for prior services rendered." *Ibid.*

The House Committee Report accompanying the bill that repealed the exception accordingly explained that, once the exception was eliminated, "a dismissal payment, which is any payment made by an employer on account of involuntary separation of the employee from the service of the employer, will constitute wages" unless and until the employee has received the maximum amount of taxable "wages" for a particular year. 1949 House Report 124; see *CSX Corp.* v. *United States*, 518 F.3d 1328, 1334 (Fed. Cir. 2008) ("[A]s of 1950, it was clear that all payments made by an employer on account of the involuntary separation of an employee from service constituted wages within the meaning of FICA."). On that understanding, the severance payments here—which were undisputedly "made by an employer on account of involuntary separation of the employee from the service of the employer"—are subject to FICA.

4. Treatment of respondents' severance payments as "wages" under FICA is also consistent with IRS guidance. A 1990 IRS Revenue Ruling concludes that FICA tax applies to severance payments unless, *inter alia*, the payments are "linked to the receipt of state unemployment compensation." Rev. Rul. 90-72, 1990-2 C.B. 211, 211; see 26 C.F.R. 601.601(d)(2) ("A

*Revenue Ruling* is an official interpretation by the [IRS] that has been published in the Internal Revenue Bulletin."). That Ruling built upon a series of prior Revenue Rulings that had addressed the circumstances in which severance payments would be treated as FICA "wages." See pp. 29-32, 34 n.5, *infra*. In this case, the parties have stipulated that respondents' severance payments "were * * * *not* tied to the receipt of state unemployment compensation," J.A. 52-53 (emphasis added), and the IRS therefore classifies those payments as "wages."

5. The court of appeals took the view (Pet. App. 9a), also embraced by respondents (Br. in Opp. 4), that this Court's decision in *Coffy* v. *Republic Steel Corp.*, 447 U.S. 191 (1980), precludes treating severance payments as FICA "wages." The court of appeals' reliance on *Coffy* was misplaced.

Although *Coffy* involved payments to laid-off employees, 447 U.S. at 198-199, the Court did not address whether those payments were FICA "wages." Instead, the disputed issue was whether those payments were "perquisites of seniority" to which a veteran returning to his civilian job was entitled under the Vietnam Era Veterans' Readjustment Assistance Act of 1974, Pub. L. No. 93-508, 88 Stat. 1578. *Coffy*, 447 U.S. at 193. Resolution of that issue turned on whether the payments were "a reward for length of service" (in which case they were covered) or "short-term compensation for services rendered" (in which case they were not). *Id.* at 197-198 (citation omitted). The Court concluded that they were the former. *Id.* at 199. Under either of those competing views, however, the payments would have been "wages" under FICA. As previously discussed, payments are generally cov-

ered by FICA so long as they arise out of the "employer-employee relationship" as a whole, even if they are not compensation for particular work "actually done." *Nierotko*, 327 U.S. at 365-366. FICA's definition of "wages" would thus encompass *both* "a reward for length of service" *and* "short-term compensation for services rendered."

The court of appeals focused (Pet. App. 7a) on two sentences in *Coffy* that characterized severance payments, including payments similar to the ones at issue here, as "'compensation for loss of jobs'" rather than "compensation for work performed." 447 U.S. at 200 (quoting *Accardi* v. *Pennsylvania R.R. Co.*, 383 U.S. 225, 230 (1966)). But while the statute at issue in *Coffy* required the Court to treat those characterizations as mutually exclusive, FICA does not. A payment can arise out of the "employer-employee relationship," *Nierotko*, 327 U.S. at 366, even if it is immediately triggered by some more particular event, such as the arrival of the holiday season (as in the case of an annual bonus) or the employee's separation (as in the case of a severance payment). Here, respondents made severance payments only to individuals with whom they had an employment relationship, and the payments were structured to reflect the nature, length, and salary conditions of that relationship. Pet. App. 3a-5a. The payments accordingly constituted "remuneration for employment," 26 U.S.C. 3121(a)—and, in particular, a "reward for length of service," *Coffy*, 447 U.S. at 199—even if they were also "compensation for loss of jobs," *id.* at 200 (citation and internal quotation marks omitted).

FICA's treatment of retirement payments underscores that a payment triggered by an employee's

separation may nevertheless qualify as "remuneration for employment." The 1954 codification of FICA excluded from the basic definition of "wages" (defined then, as now, to include "all remuneration for employment") "any payment made to an employee * * * on account of retirement." Internal Revenue Code of 1954, ch. 736, 68A Stat. 417 (26 U.S.C. 3121(a)(3) (1958)). In 1983, however, as part of an effort to enhance the fiscal health of the Social Security system, Congress repealed that exclusion. See Social Security Amendments of 1983, Pub. L. No. 98-21, Tit. III, § 324(a)(3)(B), 97 Stat. 123; H.R. Rep. No. 25, 98th Cong., 1st Sess., Pt. 1, at 2 (1983).[2] The clear implication of that repeal is that Congress intended at least some payments made "on account of retirement" to fall within the scope of FICA. See, *e.g.*, *Stone* v. *INS*, 514 U.S. 386, 397 (1995) ("When Congress acts to amend a statute, we presume it intends its amendment to have real and substantial effect."). No reasonable construction of the phrase "all remuneration for employment" could include payments made on account of retirement-based separation, while excluding payments (like the severance payments at issue here) made on account of other types of separation.

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[2] The IRS regulations that implement FICA have not been updated to reflect that repeal, and thus still specify that payments made "on account of [an] employee's retirement" are not "wages." 26 C.F.R. 31.3121(a)(3)-1. In administering the law, however, the IRS recognizes that the 1983 enactment trumps the regulation.

### B. The Court Of Appeals Erred In Construing 26 U.S.C. 3402(*o*), Which Is A Substantive Rule For Income-Tax Withholding, To Implicitly Narrow FICA's Definition Of "Wages"

In concluding that respondents' severance payments are not "wages" under FICA, the court of appeals relied primarily on its interpretation of 26 U.S.C. 3402(*o*). See Pet. App. 8a-30a. Section 3402(*o*) is not part of FICA, but instead appears in a section of the Internal Revenue Code that establishes the substantive rules for income-tax withholding. That is not the correct place to look for guidance in the interpretation of FICA's definitional provisions. In addition, the court of appeals' reading of Section 3402(*o*) reflects significant misunderstandings of that provision's text, history, and purpose.

#### *1. Section 3402(o) has no bearing on FICA's definitional provisions*

a. Chapter 24 of the Internal Revenue Code, which addresses collection of income taxes, contains a basic definition of "wages" similar to FICA's. Subject to certain exceptions, the term is defined to include "all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash." 26 U.S.C. 3401(a). Another provision of Chapter 24 requires "every employer making payment of wages" to "deduct and withhold" income tax from those "wages." 26 U.S.C. 3402(a)(1).

A subsection of that withholding statute, entitled "[e]xtension of withholding to certain payments other than wages," establishes a "[g]eneral rule" that, "[f]or purposes of" Chapter 24 and certain procedural provi-

sions, "any supplemental unemployment compensation benefit paid to an individual * * * shall be treated as if it were a payment of wages by an employer to an employee for a payroll period." 26 U.S.C. 3402(*o*)(1)(A). The term "[s]upplemental unemployment compensation benefits" is defined to mean "amounts which are paid to an employee, pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment (whether or not such separation is temporary), resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, but only to the extent such benefits are includible in the employee's gross income." 26 U.S.C. 3402(*o*)(2)(A).

The court of appeals held that the severance payments at issue in this case fall within the definition of "supplemental unemployment compensation benefits" contained in Section 3402(*o*)(2)(A). Pet. App. 11a. Based on Congress's directive that a payment meeting that definition "shall be treated as if it were a payment of wages" for purposes of income-tax withholding, the court of appeals inferred that payments covered by that definition are not *in fact* wages for income-tax-withholding purposes. *Id.* at 11a-12a. The court then concluded that such payments also could not be considered "'wages' under the nearly identical definition of that term found in the FICA statute." *Id.* at 14a.

b. The court of appeals' reliance on Section 3402(*o*) was misguided. By its terms, Section 3402(*o*) is irrelevant to the FICA definitional provisions at issue in this case. The prefatory language of Section 3402(*o*)(1) states that the rules therein—including the

rule that "supplemental unemployment compensation benefits" shall be treated as "wages" for purposes of income-tax withholding—apply "[f]or purposes of this chapter (and so much of subtitle F as relates to this chapter)." Section 3402(*o*)(1) thus applies only to Chapter 24 (income-tax withholding) and those portions of Subtitle F (matters of procedure and administration) that relate to Chapter 24. FICA, by contrast, is codified at Chapter 21 of the Internal Revenue Code.

As the Federal Circuit has explained, "Congress's decision to restrict the scope of the rule set forth in [S]ection 3402(*o*) to chapter 24 suggests that Congress did not intend that rule, or any implication that might be drawn from that rule, to be applied outside the context of income tax withholding." *CSX Corp.*, 518 F.3d at 1341. The provision does not explicitly address, and has no logical bearing on, the determination whether particular payments to terminated employees are subject to FICA. That determination is instead governed by other provisions of law. The court of appeals therefore should have construed FICA's definition of "wages" with reference to FICA's own terms, not by drawing inferences from Section 3402(*o*).

c. The enactment of Section 3402(*o*) would have been a novel, and extraordinarily indirect, way of amending FICA's definition of "wages." "[I]f [S]ection 3402(*o*) is deemed to render all [supplemental unemployment compensation benefit] payments (as defined therein) non-wages, and if the non-wage character of [such] payments (as so defined) is deemed to apply to FICA, [Section 3402(*o*)] creates a square conflict with the treatment of dismissal payments as wag-

es under FICA since 1950." *CSX Corp.*, 518 F.3d at 1341. Neither the text nor the history of Section 3402(*o*) provides any sound basis for construing it to override prior law regarding dismissal pay in that manner.

Section 3402(*o*) was enacted as part of the Tax Reform Act of 1969 (1969 Act), Pub. L. No. 91-172, § 805(g), 83 Stat. 708. Then, as now, FICA broadly defined "wages" to include "all remuneration for employment," 26 U.S.C. 3121(a) (1964), and Congress had long since repealed the exception for certain types of dismissal pay, see pp. 15-17, *supra*. If Congress had intended to exclude "supplemental unemployment compensation benefits" from FICA's definition of "wages," the natural way to do so would have been to amend the FICA definitional provisions directly. Congress did not do that. In fact, it did not even amend the definitional provisions of Chapter 24 (the income-tax-withholding chapter), which appear in 26 U.S.C. 3401.

Instead, Congress amended the *substantive* withholding rules, and included a proviso limiting the scope of the amendment to Chapter 24 and certain procedural provisions. 1969 Act § 805(g), 83 Stat. 708. In addition, Section 3402(*o*) requires not simply that certain payments be treated as "wages," but that they be treated as "a payment of wages by an employer to an employee for a payroll period." 26 U.S.C. 3402(*o*)(1). The need to determine a "payroll period," while highly relevant to the calculation of income tax to be withheld, see 26 U.S.C. 3401(b), 3402(a)(2), (b), (c) and (h)(2)-(4), has no analogue in FICA. Those aspects of Section 3402(*o*) provide additional evidence that Congress was focused on income-tax withholding,

and that the provision has no bearing on the applicability of FICA.

d. The court of appeals relied in part (Pet. App. 13a) on statements in the Senate Committee Report accompanying Section 3402(*o*). The report's description of "present law" stated that "supplemental unemployment benefits are not subject to withholding because they do not constitute wages or remuneration for services." S. Rep. No. 552, 91st Cong., 1st Sess. 268 (1969) (1969 Senate Report); see *ibid.* (stating that "these benefits are not wages"). But given the sequence of events that culminated in Section 3402(*o*)'s enactment, those statements are best understood to refer (somewhat imprecisely) to a series of IRS Revenue Rulings that had treated certain *types* of severance payments—namely, those tied to the receipt of state unemployment compensation benefits—as nonwage payments. See pp. 29-36, *infra*. To the extent those statements are viewed more broadly, as an expression of the 1969 Congress's understanding of the pre-existing statutory definitions of "wages," they are entitled to no weight because "[p]ost-enactment legislative history (a contradiction in terms) is not a legitimate tool of statutory interpretation." *Bruesewitz* v. *Wyeth LLC*, 131 S. Ct. 1068, 1081 (2011).

e. The court of appeals interpreted this Court's decision in *Rowan Cos.* v. *United States*, *supra*, to contain an "instruction that the statutory term 'wages' should be interpreted consistently in the statutes governing FICA and the federal income tax." Pet. App. 19a. Nothing in *Rowan*, however, requires courts to examine the rules governing income-tax withholding in order to interpret FICA's definition of "wages."

In *Rowan*, the Court invalidated a Treasury regulation specifying that the value of meals and lodging provided to certain employees was "includable in 'wages' as defined in FICA * * * , even though excludable from 'wages' under the substantially identical definition * * * for income-tax withholding." 452 U.S. at 252; see *id.* at 253. The Court reasoned that Congress had "intended * * * to coordinate the income-tax withholding system with FICA"; that this intent reflected Congress's interest in "simplicity and ease of administration"; and that "[c]ontradictory interpretations of substantially identical definitions do not serve that interest." *Id.* at 257.

The Court in *Rowan* had no occasion to address whether a statutory provision that governs *substantive* income-tax withholding, and that by its own terms does not apply to FICA, may be construed to narrow FICA's definition of "wages." To the extent that *Rowan* is relevant at all, however, its primary rationale suggests that Section 3402(*o*) should not be so construed. The regulations at issue in *Rowan*—which treated certain payments as "wages" for FICA purposes but not for withholding purposes—were held invalid "not for defying definitional identity" between the two statutory schemes, but instead "for failing to 'serve'" Congress's "'interest [in] simplicity and ease of administration.'" *Environmental Def.* v. *Duke Energy Corp.*, 549 U.S. 561, 575 (2007) (quoting *Rowan*, 452 U.S. at 255, 257). Here, the interest in "simplicity and ease of administration" is clearly disserved by the court of appeals' holding, which precludes the IRS from treating *any* "supplemental unemployment compensation benefits" (as defined in Section 3402(*o*)(2)(A)) as "wages" for purposes of FICA, even

though Section 3402(*o*) requires that *all* such payments be treated as "wages" for purposes of income-tax withholding.

***2. Payments covered by 26 U.S.C. 3402(o)(2)(A) can also be "wages"***

Based on Congress's directive that a defined category of payments should be "treated as * * * wages," the court of appeals inferred that *no* payments falling within that category would otherwise be "wages." Even apart from the fact that Section 3402(*o*) does not apply by its terms to FICA, the court of appeals' reading of that provision is unsound.

a. There is no literal or logical inconsistency between (a) Congress's directive that *all* payments falling within Section 3402(*o*)(2)(A)'s definition of "supplemental unemployment compensation benefits" should be treated as "wages" for a specified purpose and (b) the conclusion that *some* such payments would properly be viewed as "wages" even if the directive did not exist. As the Federal Circuit has recognized, "[t]o say that all payments falling within a particular category shall be treated as if they were a payment of wages does not dictate, as a matter of language or logic, that *none* of the payments within that category would otherwise be wages. For example, to say that for some purposes all men shall be treated as if they were six feet tall does not imply that no men are six feet tall." *CSX Corp.*, 518 F.3d at 1342 (emphasis added).

Consider, for example, a statute requiring every "commercial vehicle" to display a certain type of permit. A subsequent amendment specifying that "any pickup truck shall be treated as if it were a commercial vehicle" would not imply that *no* pickup truck is a

"commercial vehicle." Instead, the amendment would simply reflect the legislature's decision not to distinguish, for purposes of the permit requirement, between pickup trucks that are commercial vehicles (*e.g.*, gardening trucks) and pickup trucks that are not. Similarly here, Section 3402(*o*) directs that all payments falling within the statutory definition of "supplemental unemployment compensation benefits" will be subject to income-tax withholding *whether or not* they would otherwise be "wages."[3]

b. Section 3402(*o*) does appear to reflect Congress's belief that *some* of the payments encompassed by the statutory definition of "supplemental unemployment benefits" would not otherwise be viewed as "wages" for purposes of income-tax withholding. The provision would have served no useful purpose if *all* such payments were already subject to the income-tax withholding that the provision requires. The provision's history suggests that the payments Congress had in mind were the subset of "supplemental unemployment compensation benefits" that the IRS had already determined, or might later determine, to be "income" but not "wages." By providing in Section 3402(*o*) that all "supplemental unemployment compensation benefits" would be treated as "wages" for purposes of Chapter 24, Congress assured that such pay-

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[3] The court of appeals' analysis focused in part on the title of Section 3402(*o*), "Extension of withholding to certain payments other than wages." Pet. App. 12a-13a. To the extent that the title adds anything to the provision's operative text, see *Florida Dep't of Revenue* v. *Picadilly Cafeterias, Inc.*, 554 U.S. 33, 47 (2008) (suggesting that a title can help to clarify, but cannot supersede, the operative text), it is fully consistent with a belief by Congress that *some*, rather than *all*, of the payments described in Section 3402(*o*)(2)(A), would not otherwise be viewed as "wages."

ments would be subject to income-tax withholding, thereby guarding against the possibility that recipients would face large income-tax bills when their returns became due.

*IRS rulings about the scope of "wages."* In the 1950s, many large industrial employers adopted plans pursuant to collective bargaining in which the employers agreed to fund trusts that would supplement state unemployment compensation benefits for workers who were terminated. See Note, *Unemployment Insurance: Supplemental Unemployment Benefit Plans*, 1962 Duke L.J. 605, 605. Those supplemental benefits depended for their effectiveness on not being considered "wages," because employees in many States were ineligible for unemployment benefits if they were receiving "wages" from employers. *Id.* at 605-607, 609-611; see I.R.S. Tech. Adv. Mem. 94-16-003 (Apr. 22, 1994).

In 1956, the IRS issued a Revenue Ruling addressing the status, for income-tax withholding, FICA, and Federal Unemployment Tax Act (FUTA) purposes, of payments made by one such plan. See Rev. Rul. 56-249, 1956-1 C.B. 488. The IRS concluded that those payments would not be considered "wages" for purposes of income-tax withholding, FICA, and FUTA. *Id.* at 488, 492. It identified eight factors supporting that conclusion, one of which was that "the amount of [such] benefit[s] * * * is based upon * * * the appropriate State unemployment compensation laws." *Id.* at 492. The IRS additionally concluded that, even though the payments were not subject to withholding, they were still "includible in the gross incomes of [the] former employees for Federal income tax purposes." *Ibid.*; see *id.* at 488.

The plan at issue in the 1956 Revenue Ruling was the result of collective bargaining, and it created a trust to make periodic payments to terminated employees. Rev. Rul. 56-249, 1956-1 C.B. at 489. Over the course of time, as supplemental unemployment benefit plans became increasingly numerous and diverse, the IRS issued additional Revenue Rulings explaining how the principles of the 1956 Revenue Ruling would apply to other types of plans. See, *e.g.*, Rev. Rul. 58-128, 1958-1 C.B. 89; Rev. Rul. 60-330, 1960-2 C.B. 46; Rev. Rul. 77-347, 1977-2 C.B. 362; Rev. Rul. 90-72, 1990-2 C.B. 211. In 1958, for example, the IRS concluded that "supplemental unemployment benefit plans which are similar in all material details" to the plan at issue in the 1956 Revenue Ruling, "except for having been unilaterally instituted by the employer" rather than "union negotiated," would also result in the payment of income, but not "wages." Rev. Rul. 58-128, 1958-1 C.B. at 90.

*Congressional recognition of the IRS rulings.* The IRS did not identify any explicit textual basis for concluding that these types of payments were not "wages" under the applicable statutory definitions. Given the broad and facially unqualified wording of those definitions (see Part A, *supra*), it might reasonably have been disputed whether, as an original matter, the IRS was authorized to act as it did. Congress effectively acquiesced in the IRS's approach, however, by enacting complementary legislation that took the pertinent Revenue Rulings as given and ameliorated their potential unintended consequences.[4]

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[4] In any event, any doubt as to the validity of the pertinent Revenue Rulings would simply *reinforce* the conclusion that the payments at issue in this case are subject to FICA taxation. If pay-

In 1960, Congress enacted an income-tax exemption, now codified at 26 U.S.C. 501(c)(17), for certain trusts that pay "supplemental unemployment compensation benefits." Act of July 14, 1960 (1960 Act), Pub. L. No. 86-667, § 1, 74 Stat. 534. Both the House and Senate Committee Reports accompanying Section 501(c)(17) observed that "[v]arious rulings of the Internal Revenue Service have held that * * * distributions from" trusts designed to provide supplemental unemployment benefits "are taxable to the recipients as income (although not generally subject to withholding)." S. Rep. No. 1518, 86th Cong., 2d Sess. 2 (1960) (1960 Senate Report); H.R. Conf. Rep. No. 1145, 86th Cong., 1st Sess. 4 (1959) (1959 House Report). In order "to ensure tax-free status for a broad range of trusts that were used to fund payments to employees who were laid off or who suffered reductions in employment," Section 501(c)(17) "broadly" defined the term "supplemental unemployment compensation benefits" to "include a wide range of unemployment benefits as well as benefits for related loss of employment because of sickness or accident." *CSX Corp.*, 518 F.3d at 1336 (citing 1960 Senate Report 2-3; 1959 House Report 4); see 26 U.S.C. 501(c)(17)(D).

After Section 501(c)(17) was enacted, the IRS continued to promulgate Revenue Rulings addressing the proper classification of post-separation payments. In 1960, the IRS concluded that a plan that made pay-

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ments made under the plans analyzed in the Revenue Rulings were found to be FICA "wages," notwithstanding the IRS's decision to craft a limited administrative exception for payments linked to state unemployment compensation benefits, the same would be true *a fortiori* of the payments at issue here, which were not tied to state unemployment benefits. See J.A. 52-53.

ments directly to employees, rather than through a trust, was "not sufficiently different from [the plan that] formed the basis for [the 1956 Revenue Ruling] to warrant different conclusions," and it therefore deemed the plan's direct payments to be non-wage income. Rev. Rul. 60-330, 1960-2 C.B. at 48. In 1965, however, the IRS concluded that "[l]ump sum separation and severance allowances paid to laid-off employees in the railroad industry" constituted "wages" subject to income-tax withholding, as well as "compensation" subject to taxation under the railroad industry's equivalent of FICA. Rev. Rul. 65-251, 1965-2 C.B. 395, 395.

*The enactment of Section 3402(o).* In 1969, Congress added Section 3402(*o*) to address a practical problem caused by the IRS's determination that some severance payments are "income" but not "wages." Because no income tax would be withheld from such payments, the recipient might face a "significant final tax payment" at the end of the year. 1969 Senate Report 268. The Treasury Department had suggested that Congress address this problem by authorizing the agency to promulgate regulations that permitted voluntary withholding. *Statements and Recommendations of the Department of the Treasury: Hearings on H.R. 13270 Before the Senate Comm. on Finance*, 91st Cong., 1st Sess. 905-906 (1969). Congress ultimately solved the problem in a somewhat different way. Section 3402(*o*) ensures that any payment falling within the statutory definition of "supplemental unemployment compensation benefits," whether or not it would otherwise be viewed as "wages," will be "treated as" such for purposes of Chapter 24, and therefore will be subject to income-tax withholding under the

pre-existing provisions that generally govern withholdings from wage payments. See 1969 Act § 805(g), 83 Stat. 708.

Section 3402(*o*)'s definition of "supplemental unemployment compensation benefits" substantially mirrors a portion of Section 501(c)(17)'s definition of the same term. Compare 1969 Act § 805(g), 83 Stat. 708 (Section 3402(*o*)(2)(A)), with 1960 Act § 1, 74 Stat. 535 (Section 501(c)(17)(D)(i)). It therefore encompasses more than just the payments specifically linked to state unemployment compensation that the IRS had treated as non-wage income in its pre-1969 Revenue Rulings. See Rev. Rul. 56-249, 1956-1 C.B. at 489; Rev. Rul. 58-128, 1958-1 C.B. at 90; Rev. Rul. 60-330, 1960-2 C.B. at 48; Rev. Rul. 65-251, 1965-2 C.B. at 395. It would have been inadvisable, however, for Congress to have attempted to incorporate the substance of the then-existing Revenue Rulings into the text of Section 3402(*o*). Had Congress taken that approach, Section 3402(*o*) might have been only a temporary solution to the problem Congress was trying to solve. If the IRS were later to determine that some new type of benefit plan was "similar in all material details" to the plan at issue in the 1956 Revenue Ruling, Rev. Rul. 58-128, 1958-1 C.B. at 90, payments under such a plan would be treated as non-wage income and therefore would not be subject to withholding, triggering a new iteration of the same problem (large income-tax liability for the recipient at the end of the year) that the 1969 law was intended to address.

Section 3402(*o*)(2)(A)'s broad definition of "supplemental unemployment compensation benefits" encompasses both the payments linked to state unemployment compensation that the IRS had historically

treated as non-wage income, and other severance payments that the IRS had viewed as "wages." By adopting that broad definition, Congress ensured that no gaps in withholding would arise if the IRS subsequently deemed additional categories of severance payments to be non-wage income. During the ensuing 44 years, all payments within the statutory definition have continued to be subject to income-tax withholding, even as the scope of the IRS's administrative exception has changed over time.[5]

So long as Section 3402(*o*) is given only the effect that its language literally dictates (*i.e.*, that "supplemental unemployment compensation benefits" as defined in the statute be subject to income-tax withholding), the breadth of the statutory definition accommodates possible refinements in IRS practice without creating anomalous results. If, in some of its applications, Section 3402(*o*) mandates withholding of income tax from payments that would *already* be subject to income-tax withholding as "wages," no practical harm is done. See *CSX Corp.*, 518 F.3d at 1340 ("[I]t was not important for Congress to define ['supplemental unemployment compensation benefits']

---

[5] See Rev. Rul. 71-408, 1971-2 C.B. 340, 341 (concluding that "dismissal payments," similar to those in this case, were "wages" for FICA purposes); Rev. Rul. 77-347, 1977-2 C.B. at 363 (concluding that payments under a supplemental unemployment compensation benefit plan could fall outside FICA's definition of "wages" even when "benefits under the plan [were] not tied to the State's unemployment benefits"); Rev. Rul. 90-72, 1990-2 C.B. at 212 (concluding that the 1977 Revenue Ruling's "conclu[sion] that benefits do not have to be linked to state unemployment compensation in order to be excluded from the definition of wages for FICA and FUTA tax purposes is inconsistent with the underlying premises for the exclusion and is therefore hereby revoked").

narrowly or to distinguish between [those] payments and 'dismissal' payments, since both were treated similarly for withholding purposes."). The breadth of Section 3402(*o*)(2)(A)'s definition creates practical difficulties only if that definition is used (as the court below used it) to determine which severance payments should be treated as FICA "wages," thereby effectively expanding the IRS's limited administrative exception for payments linked to state unemployment compensation.

c. Neither the court of appeals nor respondents have offered a reasonable alternative explanation of Section 3402(*o*)'s origin or purpose that would support their interpretation of the provision. In particular, there is no plausible basis for inferring that the 1969 Congress either (1) viewed the pre-existing statutory definition of "wages" (in either FICA or Chapter 24) as *already* excluding all "supplemental unemployment compensation benefits" or (2) intended to amend the (FICA or Chapter 24) definition of "wages" to exclude such benefits.

The 1969 Congress could not reasonably have believed that *all* of the payments it defined as "supplemental unemployment compensation benefits" fell outside the existing statutory definition of "wages." As explained in Part A, *supra*, the definitional phrase "all remuneration for employment" has an expansive reach and had been construed broadly by this Court, see *Nierotko*, 327 U.S. at 365-366, by the time Section 3402(*o*) was enacted. Although some statements in Section 3402(o)'s legislative history referred to "supplemental unemployment compensation benefits" as non-wage income under pre-1969 law, see, *e.g.*, Pet. App. 13a (discussing legislative history), those state-

ments are better understood as imprecise references to the IRS Revenue Rulings described above, which had excepted *some* types of severance payments from treatment as "wages." Neither those Rulings nor the statutory definitions of "wages" would have led Congress to believe that "supplemental unemployment compensation benefits" were categorically uncovered.

It would be even more implausible to construe Section 3402(*o*) as an affirmative effort by Congress to narrow the pre-existing definition of "wages." Both the Chapter 24 and FICA definitions of "wages" had long been understood to cover dismissal payments. See 26 C.F.R. 31.3401(a)-1(b)(4) (1968) (specifying that, for purposes of Chapter 24, "[a]ny payments made by an employer to an employee on account of dismissal, that is, involuntary separation from the service of the employer, constitute wages"); pp. 15-17, *supra* (discussing FICA's longstanding coverage of dismissal pay). And Section 3402(*o*) was designed to *increase* the incidence of income-tax withholding. If Congress had intended either to *limit* Chapter 24's definition of "wages," or to *eliminate* FICA tax for the sorts of dismissal payments historically treated as "wages" under FICA, the language it used in Section 3402(*o*) would have been a remarkably oblique way of accomplishing that result. Cf. *United States* v. *Wells Fargo Bank*, 485 U.S. 351, 354 (1988) (reiterating the "settled principle that exemptions from taxation are not to be implied; they must be unambiguously proved").

## CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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NOVEMBER 2013

## STATUTORY APPENDIX

1. 26 U.S.C. 3121 provides in pertinent part:

**Definitions**

**(a) Wages**

For purposes of this chapter, the term "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include—

* * * * *

**(b) Employment**

For purposes of this chapter, the term "employment" means any service, of whatever nature, performed (A) by an employee for the person employing him, irrespective of the citizenship or residence of either, (i) within the United States, or (ii) on or in connection with an American vessel or American aircraft under a contract of service which is entered into within the United States or during the performance of which and while the employee is employed on the vessel or aircraft it touches at a port in the United States, if the employee is employed on and in connection with such vessel or aircraft when outside the United States, or (B) outside the United States by a citizen or resident of the United States as an employee for an American employer (as defined in subsection (h)), or (C) if it is service, regardless of where or by whom performed, which is designated as employment or recognized as equivalent to employment under an agree-

ment entered into under section 233 of the Social Security Act; except that such term shall not include—

* * * * *

2. 26 U.S.C. 3401 provides in pertinent part:

**(a) Wages**

For purposes of this chapter, the term "wages" means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include remuneration paid—

* * * * *

3. 26 U.S.C. 3402 provides in pertinent part:

**Income tax collected at source**

**(a) Requirement of withholding**

**(1) In general**

Except as otherwise provided in this section, every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary. * * *

* * * * *

**(*o*) Extension of withholding to certain payments other than wages**

**(1) General rule**

For purposes of this chapter (and so much of subtitle F as relates to this chapter)—

(A) any supplemental unemployment compensation benefit paid to an individual,

(B) any payment of an annuity to an individual, if at the time the payment is made a request that such annuity be subject to withholding under this chapter is in effect, and

(C) any payment to an individual of sick pay which does not constitute wages (determined without regard to this subsection), if at the time the payment is made a request that such sick pay be subject to withholding under this chapter is in effect,

shall be treated as if it were a payment of wages by an employer to an employee for a payroll period.

**(2) Definitions**

**(A) Supplemental unemployment compensation benefits**

For purposes of paragraph (1), the term "supplemental unemployment compensation benefits" means amounts which are paid to an employee, pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment (wheth-

er or not such separation is temporary), resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, but only to the extent such benefits are includible in the employee's gross income.

* * * * *

# RESPONDENT'S BRIEF

RECORD
AND
BRIEFS

No. 12-1408

# In The Supreme Court of the United States

UNITED STATES OF AMERICA,

*Petitioner,*

v.

QUALITY STORES, INC., ET AL.,

*Respondents.*

**On Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit**

## BRIEF FOR RESPONDENTS

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## QUESTION PRESENTED

Whether "supplemental unemployment compensation benefits," which Congress has defined as amounts "paid to an employee, pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment . . . resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions," 26 U.S.C. § 3402(o), constitute wages for purposes of the Federal Insurance Contributions Act, 26 U.S.C. §§ 3101-3128.

## PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

Petitioner is the United States of America.

Respondents are QSI Holdings, Inc. (f/k/a CT Holdings, Inc.); Quality Stores, Inc. (f/k/a Central Tractor Farm & Country, Inc.); Country General, Inc.; F and C Holding, Inc.; FarmandCountry.com, LLC; QSI Newco, Inc.; QSI Transportation, Inc.; Quality Farm & Fleet, Inc.; Quality Investments, Inc.; Quality Stores Services, Inc.; and Vision Transportation, Inc.

Respondents, through Rivershore Advisors, LLC, the Chief Litigation Officer appointed pursuant to the confirmed Chapter 11 plan of reorganization, serve as representatives of creditors of post-confirmation bankruptcy estates, some of which may be publicly-traded companies. None of Respondents is a subsidiary or affiliate of a publicly-traded corporation.

TABLE OF CONTENTS


| | Page |
|---|---|
| OPINIONS BELOW | 1 |
| JURISDICTION | 1 |
| STATUTES AND REGULATORY PROVISIONS INVOLVED | 2 |
| STATEMENT OF THE CASE | 2 |
| I. Statutory Background | 3 |
| II. Factual Background and Proceedings Below | 8 |
| SUMMARY OF ARGUMENT | 10 |
| ARGUMENT | 16 |
| I. SUB Payments Are Not Wages for Income Tax Withholding Purposes | 17 |
| A. The Plain Language of Internal Revenue Code Sections 3401 and 3402 Demonstrates that SUB Payments Are Not Wages | 17 |
| B. The Government's Position that Only Some SUB Payments Are Excluded from the Definition of Wages Is Contrary to the Plain Language of the Statute and the Canons of Statutory Interpretation | 19 |
| C. The Legislative History Confirms that SUB Payments Are Not Wages | 24 |

TABLE OF CONTENTS – Continued

Page

D. The Government's Insistence that "Dismissal Payments" Are Wages Is Irrelevant to the Issue Before the Court ..... 29

E. This Court's Ruling in *Coffy* Strongly Supports the Conclusion that SUB Payments Are Not Wages ..... 33

F. This Court's Decisions in *Nierotko*, *Otte* and *Mayo* Are Distinguishable and Do Not Support a Finding that SUB Payments Are Wages ..... 35

II. The Internal Revenue Code Defines "Wages" Substantially Identically for Income Tax Withholding and FICA Taxation Purposes, and Therefore Must Be Construed *In Pari Materia* ..... 39

A. The Definitions of "Wages" Under Section 3121 (FICA Taxation) and Section 3401 (Income Tax Withholding) Are Substantially Identical ..... 40

B. Under *Rowan*, "Wages" Must Be Given the Same Meaning for Income Tax Withholding and FICA Taxation Purposes ..... 42

C. The Government's Arguments for Distinguishing the Definition of Wages Under FICA from the Definition of Wages for Income Tax Withholding Are Without Merit ..... 45

TABLE OF CONTENTS – Continued

Page

1. Section 3402(o) Did Not Alter the Definition of "Wages" But Rather Recognized the State of the "Present Law" ..... 45

2. The Government's Position that SUB Payments Must Meet the Revenue Rulings' Definition Is Wrong ..... 49

(a) Revenue Rulings Lack the Force and Effect of Law ..... 51

(b) Revenue Rulings Are Not Entitled to *Chevron* Deference ..... 52

(c) These Revenue Rulings Lack Persuasive Power under *Skidmore* ..... 53

(i) The IRS Has Repeatedly Changed Its Position in Its Revenue Rulings as to the Requirements for SUB Payments ..... 54

(ii) The Revenue Rulings Are Not Well-Reasoned and Articulate No Sound Basis for Departing from the Plain Language of the Statute ..... 58

CONCLUSION ..... 60

TABLE OF CONTENTS – Continued

Page

SUPPLEMENTAL APPENDIX

Statutes and Regulatory Provisions Involved ..... 1a

# TABLE OF AUTHORITIES

Page

CASES

*Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984) ..... 14, 15, 51, 52, 53

*Christensen v. Harris County*, 529 U.S. 576 (2000) ..... 52

*Coffy v. Republic Steel Corp.*, 447 U.S. 191 (1980) ..... *passim*

*Connecticut Nat'l Bank v. Germain*, 503 U.S. 249 (1992) ..... 21

*CSX Corp. v. United States*, 518 F.3d 1328 (Fed. Cir. 2008) ..... 31, 47, 48

*Dixon v. United States*, 381 U.S. 68 (1965) ..... 51

*General Elec. Co. v. Gilbert*, 429 U.S. 125 (1976), *superseded on other grounds by* 92 Stat. 2076, 42 U.S.C. § 2000e(k) ..... 15, 56

*In re Griffith*, 206 F.3d 1389 (11th Cir. 2000) (*en banc*) ..... 23

*INS v. National Ctr. for Immigrants' Rights*, 502 U.S. 183 (1991) ..... 19

*Jimenez v. Quarterman*, 555 U.S. 113 (2009) ..... 17

*Mayo Found. for Med. Educ. & Research v. United States*, 131 S. Ct. 704 (2011) ..... 35, 38

*Milavetz, Gallop & Milavetz, P.A. v. United States*, 559 U.S. 229 (2010) ..... 24

*National Federation of Independent Business v. Sebelius*, 132 S. Ct. 2566 (2012) ..... 21, 22

TABLE OF AUTHORITIES – Continued

Page

*Otte v. United States*, 419 U.S. 43 (1974) .....35, 37, 38

*Rowan Cos. v. United States*, 452 U.S. 247 (1981).....*passim*

*Russello v. United States*, 464 U.S. 16 (1983).....23

*Skidmore v. Swift & Co.*, 323 U.S. 134 (1944)....*passim*

*Social Sec. Bd. v. Nierotko*, 327 U.S. 358 (1946) ...*passim*

*TRW Inc. v. Andrews*, 534 U.S. 19 (2001).....24

*United Housing Found., Inc. v. Forman*, 421 U.S. 837 (1975).....15

*United States v. Gonzales*, 520 U.S. 1 (1997) .....24

*United States v. Mead Corp.*, 533 U.S. 218 (2001).....52

*Zedner v. United States*, 547 U.S. 489 (2006).....24

STATUTES

26 U.S.C. § 501(c)(17).....*passim*

26 U.S.C. § 3121(a).....*passim*

26 U.S.C. § 3121(b).....7, 40

26 U.S.C. § 3304(a).....31

26 U.S.C. § 3401(a).....*passim*

26 U.S.C. § 3402(o).....*passim*

28 U.S.C. § 1254(1).....1

Federal Insurance Contributions Act, 26 U.S.C. §§ 3101-3128.....*passim*

TABLE OF AUTHORITIES – Continued

Page

Federal Unemployment Tax Act, 26 U.S.C. §§ 3301-3311 ..... 43

Federal-State Extended Unemployment Compensation Act of 1970, § 202(a)(3)(D), Pub. L. No. 91-373, 84 Stat. 708 (1970), as amended by Pub. L. No. 96-499, 94 Stat. 2659 (1980) ..... 31

Pub. L. No. 86-667, 74 Stat. 534 (1960) ..... 3, 27

Pub. L. No. 98-21, § 327(b)(1), 97 Stat. 65 (1983) ..... 48, 49

OTHER AUTHORITIES

Rev. Proc. 89-14, 1989-1 C.B. 814 ..... 14, 51

Rev. Rul. 56-249, 1956-1 C.B. 488 ..... 15, 53, 54, 55, 57

Rev. Rul. 59-227, 1959-2 C.B. 13 ..... 15, 53, 55

Rev. Rul. 77-347, 1977-2 C.B. 362 ..... 15, 53, 55, 56

Rev. Rul. 90-72, 1990-2 C.B. 211 ..... *passim*

S. Rep. No. 91-552 (1969), reprinted in 1969 U.S.C.C.A.N. 2027 ..... *passim*

S. Rep. No. 96-1033 (1980) ..... 22

Statements and Recommendations of the Department of the Treasury: Hearings on H.R. 13270 Before the Senate Comm. on Finance, 91st Cong. 1st Sess. 905 app. (1969) ..... 26

T.D. 6972, 1968-2 C.B. 222; 33 Fed. Reg. 12,899 (Sept. 12, 1968) ..... 2, 4, 28

TABLE OF AUTHORITIES – Continued

Page

T.D. 7068, 1970-2 C.B. 252; 35 Fed. Reg. 17,328 (Nov. 11, 1970) ..... 2, 4, 28

Treas. Reg. § 1.501(c)(17)-2(j) (as amended in 1970) ..... 2, 4, 28

Treas. Reg. § 1.6041-2(b) (as amended in 2004) ..... 2, 4, 28, 30

Treas. Reg. §§ 31.3121(a)-1(c)-(e) (as amended in 2003) ..... 34

Treas. Reg. § 31.3401(a)-1(b) (as amended in 2003) ..... 2, 30

Treas. Reg. § 601.601(d)(2)(v)(*d*) (as amended in 1987) ..... 14

## OPINIONS BELOW

The opinion of the United States Court of Appeals for the Sixth Circuit (Pet. App. 1a-30a) is reported at 693 F.3d 605, *cert. granted*, 186 L. Ed. 2d 962 (2013). The opinion of the United States District Court for the Western District of Michigan (Pet. App. 33a-54a) is reported at 424 B.R. 237, *cert. granted*, 186 L. Ed. 2d 962 (2013). The opinion of the United States Bankruptcy Court for the Western District of Michigan (Pet. App. 55a-77a) is reported at 383 B.R. 67, *cert. granted*, 186 L. Ed. 2d 962 (2013).

## JURISDICTION

The judgment of the court of appeals was entered on September 7, 2012. A petition for rehearing and rehearing *en banc* was denied on January 4, 2013. Pet. App. 31a-32a. On March 25, 2013, the Chief Justice extended the time within which to file a petition for a writ of certiorari to and including May 3, 2013. On April 22, 2013, the Chief Justice further extended the time within which to file a petition for a writ of certiorari to and including May 31, 2013. The jurisdiction of this Court was invoked under 28 U.S.C. § 1254(1).

## STATUTES AND REGULATORY PROVISIONS INVOLVED

Copies of 26 U.S.C. § 501(c)(17)(D), Treas. Reg. §§ 1.501(c)(17)-2(j) (as amended in 1970), 1.6041-2(b)(1) (as amended in 2004) and 31.3401(a)-1(b)(14)(i) and (ii) (as amended in 2003), T.D. 6972, 1968-2 C.B. 222; 33 Fed. Reg. 12,899 (Sept. 12, 1968), and T.D. 7068, 1970-2 C.B. 252; 35 Fed. Reg. 17,328 (Nov. 11, 1970), are reproduced in the supplemental appendix to this brief. Supp. App., infra, 1a-6a. Other relevant statutory and regulatory provisions are reproduced in the appendix to Petitioner's brief and in the appendix to the petition for a writ of certiorari. Pet. App. 84a-214a.

## STATEMENT OF THE CASE

This case involves the treatment, for purposes of taxation under the Federal Insurance Contributions Act, 26 U.S.C. §§ 3101-3128 ("FICA"), of supplemental unemployment compensation benefits paid by Quality Stores Inc., *et al.* (collectively, "Quality Stores" or "Respondents") to certain employees who were laid off when Quality Stores closed its doors. Only payments that fall within the definition of "wages" are subject to FICA taxation. Quality Stores contends that since the supplemental unemployment compensation benefits are not "wages" for income tax withholding purposes, they are likewise not "wages" under FICA.

The United States of America (the "Government") disagrees, arguing that supplemental unemployment

compensation benefits are "wages" under FICA unless – in addition to meeting the statutory definition set forth in Section 3402(o)(2)(A) of the Internal Revenue Code – the benefits payments also meet the specific criteria set forth in the IRS' most recent revenue ruling on the topic.

The bankruptcy court, district court and court of appeals all concluded that "wages" should be interpreted in the same way for both income tax withholding and FICA taxation purposes, and that supplemental unemployment compensation benefits are not "wages" for either purpose.

## I. Statutory Background

1. Supplemental unemployment compensation benefits ("SUB payments") have existed in various forms since the 1950s. In 1960, Congress amended the Internal Revenue Code ("IRC") to provide an income tax exemption for trusts established to make SUB payments. Pub. L. No. 86-667, 74 Stat. 534 (1960). In doing so, Congress defined SUB payments as "benefits which are paid to an employee because of his involuntary separation from the employment of the employer (whether or not such separation is temporary) resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions. . . ." 74 Stat. at 535. This definition remains in the statute today. 26 U.S.C. § 501(c)(17)(D).

The Treasury Department recognized that all SUB payments, as defined in IRC Section 501(c)(17)(D), were non-wages. In 1968, after notice and comment, the Treasury Department promulgated regulations relative to IRC Section 501(c)(17). Those Treasury regulations required SUB payments of $600 or more to be reported on Form 1099 – a reporting form that cannot be used to report wages for income tax withholding or FICA taxation purposes. *See* Treas. Reg. §§ 1.501(c)(17)-2(j) (as amended in 1970) and 1.6041-2(b) (as amended in 2004); T.D. 6972, 1968-2 C.B. 222, 229 and 239; 33 Fed. Reg. 12,899 (Sept. 12, 1968).

2. The following year, Congress again amended the IRC with respect to SUB payments by enacting Section 3402(o). That provision extended income tax withholding to SUB payments, which it defined, almost verbatim, in the same manner as in Section 501(c)(17). The legislative history of Section 3402(o) states the reason for the amendment:

> Present law. – Under present law, supplemental unemployment benefits are not subject to withholding because they do not constitute wages or remuneration for services.
>
> General reasons for change. – Supplemental unemployment compensation benefits . . . paid by employers are generally taxable income to the recipient. Consequently, the absence of withholding on these benefits may require a significant final tax payment by the taxpayer receiving them. The committee

> concluded that although these benefits are not wages, since they are generally taxable payments they should be subject to withholding to avoid the final tax payment problem for employees.

S. Rep. No. 91-552 at 268 (1969), reprinted in 1969 U.S.C.C.A.N. 2027, 2305-06.

The title of IRC Section 3402(o) states that it extends income tax withholding "to certain payments *other than wages*." 26 U.S.C. § 3402(o) (emphasis added). The section identifies three types of payments, other than wages, to which income tax withholding is nonetheless applied: "(A) any supplemental unemployment compensation benefit paid to an individual, (B) any payment of an annuity to an individual . . . , and (C) any payment to an individual of sick pay which does not constitute wages (determined without regard to this subsection). . . ." 26 U.S.C. § 3402(o)(1)(A)-(C).

As in Section 501(c)(17)(D), SUB payments are defined in Section 3402(o) as

> amounts which are paid to an employee, pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment (whether or not such separation is temporary), resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions. . . .

26 U.S.C. § 3402(o)(2)(A).

Although SUB payments are among the payments that the statute describes as "other than wages," Section 3402(o) mandates that a SUB payment "shall be treated *as if it were* a payment of wages by an employer to an employee for a payroll period." 26 U.S.C. § 3402(o)(1) (emphasis added). Employers are therefore required to withhold income taxes from SUB payments even though SUB payments are not wages.

Section 3402(o) is necessary because SUB payments are taxable as income to recipients, but – because they are not wages – are not otherwise subject to income tax withholding, as established by the 1968 Treasury regulations preceding the enactment of Section 3402(o). As a result, prior to Section 3402(o)'s enactment, recipients would face potentially heavy tax burdens when they filed their returns. As the Government noted in its Petition, "[i]n 1969, at the Treasury Department's suggestion, Congress enacted Section 3402(o) to address that particular problem." Pet. 16.

3. Neither the 1968 Treasury regulations nor the 1969 legislative history of Section 3402(o) state anywhere that SUB payments, although non-wages for purposes of income tax withholding, nonetheless are wages for purposes of FICA taxation. Rather, the IRC defines the term "wages" substantially identically under Section 3121(a) (FICA taxation) and Section 3401(a) (income tax withholding):

| Section 3121(a) | Section 3401(a) |
| --- | --- |
| For purposes of this chapter, the term "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash; . . . | For purposes of this chapter, the term "wages" means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash; . . . |

26 U.S.C. §§ 3121(a), 3401(a).

Section 3121(b), in turn, defines "employment" for FICA taxation purposes as "any service, of whatever nature, performed by an employee for the person employing him. . . . ," thereby completing the parallel between the two sections defining "wages." *See* 26 U.S.C. § 3121(b)(A).

Section 3402(o)'s requirement that a SUB payment be treated *as if it were* a payment of wages is expressly limited to the chapter relating to income tax withholding. *See* 26 U.S.C. § 3402(o)(1) ("For purposes of this chapter (and so much of subtitle F as relates to this chapter) – "). Thus, Congress did not mandate treating SUB payments as if they were wages for FICA taxation or any other purpose.

## II. Factual Background and Proceedings Below[1]

1. Quality Stores, an agricultural specialty retailer, closed all of its stores and distribution centers, terminated the employment of all its employees, and made payments to employees whose employment was involuntarily terminated (the "Payments"). Pet. App. 2a-3a. Quality Stores and the Government have stipulated that the Payments resulted directly from a reduction in force or the discontinuance of a plant or operation and were not attributable to the rendering of any particular services by the former employees. Government's Brief ("Br.") 6 n.1; Joint Appendix ("J.A.") 51-53.

2. Because the Payments constituted gross income to the employees for federal income tax purposes, Quality Stores reported the Payments as wages on W-2 forms and withheld federal income tax. Quality Stores also paid the employer's share of taxes under FICA and withheld each employee's share of FICA tax. Although Quality Stores collected and paid the FICA tax, it did not agree with the Internal Revenue Service ("IRS") that the Payments constituted "wages" for FICA purposes. Quality Stores believed that the Payments instead constituted SUB payments that are not taxable under FICA.

---

[1] The facts in this case are set forth in the opinion of the court of appeals. Pet. App. 2a-7a, 11a.

Pet. App. 5a. Accordingly, Quality Stores filed claims for refund of the FICA taxes.

After the IRS failed to act on the claims for refund, Quality Stores filed a proceeding against the Government in the bankruptcy court where its chapter 11 case was pending, seeking to recover the overpaid employer and employee FICA taxes plus interest. Pet. App. 37a.

The bankruptcy court held that Quality Stores and its employees were not liable for FICA taxes and were entitled to a refund of the FICA taxes previously paid. Pet. App. 55a-77a. The Government moved for reconsideration. Pet. App. 78a. The bankruptcy court granted the Government's motion for reconsideration, but ratified its prior decision. Pet. App. 78a-80a.

After the parties filed a stipulation regarding the amount of the FICA tax refund to be paid, the bankruptcy court entered a final judgment in favor of Quality Stores and its employees in the amount of $1,000,125.00 plus interest as provided by law. Pet. App. 81a-83a. The Government appealed, and the district court affirmed the judgment of the bankruptcy court. Pet. App. 33a-54a.

3. The Government appealed again, and the court of appeals unanimously affirmed the decision of the district court. Pet. App. 1a-30a. The Government filed a petition for rehearing *en banc*, which the court of appeals denied on January 4, 2013. Pet. App. 31a-32a.

## SUMMARY OF ARGUMENT

This Court should affirm the judgment below because the court of appeals correctly found that SUB payments are not "wages" for income tax withholding purposes and, consistent with the Court's holding in *Rowan Cos. v. United States*, 452 U.S. 247 (1981), correctly found that SUB payments likewise are not "wages" for FICA taxation purposes.

1. The Payments were made by Quality Stores pursuant to two plans to which Quality Stores was a party, because of employees' involuntary separation from employment resulting directly from a reduction in force or the discontinuance of a plant or operation. There can be no dispute that the Payments made by Quality Stores to its employees meet the statutory definition of "supplemental unemployment compensation benefits" in IRC Section 3402(o), which defines SUB payments for purposes of income tax withholding. Br. 6 n.1; J.A. 51-53.

2. The plain language of Section 3402(o) clearly recognizes that SUB payments are not wages, but rather are to be treated *as if they were wages* solely for purposes of income tax withholding. This is confirmed by the legislative history of Section 3402(o), which explains that Congress enacted the section precisely because SUB payments are not wages, and thus are not subject to income tax withholding even though included in taxable income. S. Rep. No. 91-552 at 268 (1969), reprinted in 1969 U.S.C.C.A.N. 2027, 2305-06 ("The committee concluded that *although*

*these benefits are not wages*, since they are generally taxable payments they should be subject to withholding to avoid the final tax payment problem for employees.") (emphasis added).

This Court's decision in *Coffy v. Republic Steel Corp.*, 447 U.S. 191 (1980) further supports the position that SUB payments do not constitute wages, since they are not remuneration to an employee for services performed. As the Court explained, "SUB's cannot be compensation for work performed, . . . for they are contingent on the employee's being thrown out of work; unless the employee is laid off he will never receive SUB payments." *Id.* at 200.

3. The Government argues that SUB payments must be wages for FICA purposes because they do not fit within any of the enumerated statutory exceptions to FICA's definition of wages. The Government ignores the fact that a specific exception for SUB payments would only be needed if SUB payments met the definition of wages in the first instance. The statutory language and the legislative history of Section 3402(o) demonstrate that they do not. *See* S. Rep. No. 91-552 at 268 (1969), reprinted in 1969 U.S.C.C.A.N. 2027, 2305-06.

Moreover, the statute defining wages for income tax withholding purposes, like the statute defining wages for FICA purposes, contains a long list of specific exceptions – none of which covers SUB payments. Despite this omission, the Government concedes that at least *some* SUB payments are not

"wages" for purposes of income tax withholding. Br. 33. Clearly, the lack of a specific exception for SUB payments from the statutory definition of wages for either income tax withholding or FICA purposes is not determinative of the status of SUB payments.

The Government further suggests that this Court's decision in *Social Sec. Bd. v. Nierotko*, 327 U.S. 358 (1946), mandates a finding that virtually any payment made by an employer to a current or former employee – including SUB payments – constitutes wages. This is a bridge too far; although *Nierotko*'s definition of wages is broad, it is not unlimited. In *Nierotko*, the Court, in the course of determining whether back pay constitutes wages under the Social Security Act,[2] addressed the breadth of the term "employment," which is part of the definition of wages. The Court explained that "'any service . . . performed . . . for his employer' . . . means not only work actually done but the entire employer-employee relationship for which compensation is paid to the employee by the employer." *Id.* at 365-66 (citations omitted).

The facts in *Nierotko* are critical to understanding its holding. The employee had been wrongfully terminated before being reinstated, and under the

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[2] At the time the Court decided *Nierotko*, the Social Security Act's definitions of both "wages" and "employment" were identical to the current definitions for FICA purposes under IRC Chapter 21. *See Nierotko*, 327 U.S. at 361; 26 U.S.C. § 3121(a).

National Labor Relations Act was legally still an employee for the duration of his wrongful termination:

> Since Nierotko remained an employee under the definition of the Labor Act, although his employer had attempted to terminate the relationship, *he had "employment"* under that Act and we need consider further only *whether under the Social Security Act its definition of employment, as "any service . . . performed . . . by an employee for his employer," covers what Nierotko did for the Ford Motor Company.*

*Nierotko*, 327 U.S. at 365 (emphasis added). In other words, the back pay that the employee received was compensation paid while he remained an employee and still had employment that met the definition of that term under the Social Security Act, notwithstanding the fact that he did not actually perform work during the employer's attempted termination of his employment.

The facts in *Nierotko* are plainly distinguishable from those in this case, where SUB payments were paid as part of a reduction in force or plant closing and the recipients did not legally remain employees or continue to have "employment" of any kind with Quality Stores. The exclusion of SUB payments from wages is in no way inconsistent with *Nierotko's* holding that wages should be construed broadly. Thus, the Government's reliance on *Nierotko* is misplaced.

4. Finally, while admitting that the statutory definition of "wages" in Section 3401 does not encompass all SUB payments, the Government contends that the *only* SUB payments that are excluded from the definition are those that meet the shifting requirements of the IRS' revenue rulings. Thus, the Government argues, any SUB payments that do not meet the IRS' current requirements (or such contrary requirements as the IRS may in the future adopt) *are* wages. Br. 36. Although the Government does not explicitly argue that the IRS' revenue rulings are entitled to judicial deference under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), its position necessarily presumes that the IRS' administrative opinions are controlling as a matter of law.

There is no merit to the Government's position that the IRS' revenue rulings, rather than the definition adopted by Congress, determine whether SUB payments are wages. The Government has failed to articulate any reason why the Court should defer to the IRS' revenue rulings as authoritative. As the IRS itself concedes, such rulings do not have the force or effect of Treasury regulations. Rev. Proc. 89-14, 1989-1 C.B. 814 ("Revenue rulings published in the Bulletin do not have the force and effect of Treasury Department regulations. . . ."); *see also* Treas. Reg. § 601.601(d)(2)(v)(*d*) (as amended in 1987). Even more importantly, the IRS' revenue rulings regarding what constitutes non-wage SUB payments are inconsistent with the statutory definition of SUB

payments. Accordingly, the revenue rulings are not entitled to judicial deference under *Chevron*.

Nor do the revenue rulings have the "power to persuade" necessary to be entitled to respect under *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944). The Government makes no effort to defend the correctness of the IRS' revenue rulings. Indeed, it would be hard-pressed to do so, given that the IRS has, not once but twice, changed its mind about whether, in order to constitute non-wages, SUB payments must be linked to state unemployment benefits, and, not once but twice, changed its mind about whether SUB payments may be received in a lump sum. *See* Rev. Rul. 56-249, 1956-1 C.B. 488; Rev. Rul. 59-227, 1959-2 C.B. 13; Rev. Rul. 77-347, 1977-2 C.B. 362; Rev. Rul. 90-72, 1990-2 C.B. 211.

This Court has declined to give any special weight to administrative interpretations where those interpretations conflict with earlier pronouncements of the agency. *See General Elec. Co. v. Gilbert*, 429 U.S. 125, 142-143 (1976), *superseded on other grounds by* 92 Stat. 2076, 42 U.S.C. § 2000e(k) (citing *United Housing Found., Inc. v. Forman*, 421 U.S. 837, 858 n.25 (1975)). Thus, the most current iteration of the IRS' opinion on what constitutes a non-wage SUB payment is entitled to no special weight. It is the statute, not the revenue rulings, that determines what a SUB payment is and whether it is within the definition of "wages."

5. This Court's holding in *Rowan* requires that the definition of wages under FICA be construed consistently with the definition of wages for income tax withholding. Therefore, because payments meeting the statutory definition of SUB payments under Section 3402(o) clearly do not fall within the definition of wages for purposes of income tax withholding, those payments are also not wages for purposes of FICA taxation.

## ARGUMENT

### SUB PAYMENTS MADE BY QUALITY STORES TO FORMER EMPLOYEES ARE NOT WAGES FOR PURPOSES OF FEDERAL INSURANCE CONTRIBUTIONS ACT TAXATION

The parties have stipulated that the Payments made by Quality Stores to its laid-off employees were paid pursuant to two plans to which Quality Stores was a party, because of the employees' involuntary separation from employment, resulting directly from a reduction in force or the discontinuance of a plant or operation. The parties have further stipulated that the Payments were not attributable to the rendering of any particular services by the former employees who received them. Accordingly, there can be no dispute that the Payments meet the statutory definition of "supplemental unemployment compensation benefits" set forth in IRC Section 3402(o)(2)(A). As SUB payments, the benefits paid by Quality Stores – although taxable income to the former employees –

are not "wages" for income tax withholding purposes, nor are they "wages" for FICA taxation.

## I. SUB Payments Are Not Wages for Income Tax Withholding Purposes

### A. The Plain Language of Internal Revenue Code Sections 3401 and 3402 Demonstrates that SUB Payments Are Not Wages

As with any question of statutory interpretation, the analysis must begin – and may well end – with the plain language of the statute. *Jimenez v. Quarterman*, 555 U.S. 113, 118 (2009) ("It is well established that, when the statutory language is plain, we must enforce it according to its terms.") (citations omitted).

The IRC's income tax withholding provisions define "wages" as "all remuneration . . . for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash." 26 U.S.C. § 3401(a). *See* Pet. App. 148a-154a. Thus, based on the plain language of the statute, a payment constitutes "wages" – and must have income tax withheld from it – only if it is (1) remuneration (2) for services (3) performed by an employee for his employer.

Although this definition of wages is broad, it is not all-encompassing: some payments simply cannot be deemed to be "remuneration . . . for services performed by an employee for his employer." A SUB

payment is a type of payment that – although made by an employer to his former employee – nonetheless does not meet the statutory definition of "wages" because it is not remuneration for services. The IRC defines "supplemental unemployment compensation benefits" as:

> amounts which are paid to an employee, pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment (whether or not such separation is temporary), resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, but only to the extent such benefits are includible in the employee's gross income.

26 U.S.C. § 3402(o)(2)(A). As this Court explained in *Coffy*, "SUB's cannot be compensation for work performed, . . . for they are contingent on the employee's being thrown out of work; unless the employee is laid off he will never receive SUB payments." 447 U.S. at 200.

That SUB payments are not wages is borne out by the plain language of Section 3402(o). Section 3402(o) extends the income tax withholding requirement to "certain payments *other than wages*,"[3] including

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[3] Although Quality Stores believes that the statutory language is plain, to the extent that there is any ambiguity under Section 3402(o) as to the wage or non-wage status of SUB payments, the title of the section is instructive. *See* Pet. App.

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(1) "any supplemental unemployment compensation benefit paid to an individual" (SUB payments); (2) certain annuity payments to an individual; and (3) certain payments of sick pay to an individual. 26 U.S.C. § 3402(o) (emphasis added). *See* Pet. App. 174a-179a. Section 3402(o)(1) requires that each of these types of payments shall be "treated *as if it were* a payment of wages" for income tax withholding purposes. 26 U.S.C. § 3402(o)(1) (emphasis added). The most logical inference to be drawn from this statutory language is that these types of payments were not wages; if they were wages, Congress would not have needed to enact Section 3402(o) to provide for the withholding of income taxes because such withholding already would have been occurring.

### B. The Government's Position that Only Some SUB Payments Are Excluded from the Definition of Wages Is Contrary to the Plain Language of the Statute and the Canons of Statutory Interpretation

The Government concedes (as it must) that at least some SUB payments do not constitute wages within the meaning of the statute, since there otherwise would have been no need for Congress to enact Section 3402(o). *See* Br. 28. The Government insists,

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12a-13a; *INS v. National Ctr. for Immigrants' Rights*, 502 U.S. 183, 189 (1991) ("[T]he title of a statute or section can aid in resolving an ambiguity in the legislation's text.").

however, that while some payments meeting the definition of SUB payments in Section 3402(o)(2)(A) are not wages, other SUB payments that likewise meet Section 3402(o)(2)(A)'s requirements nonetheless *are* wages. In the Government's view, meeting all of the requirements of the definition enacted by Congress is not enough to qualify a payment as a non-wage SUB payment. Rather, to be excluded from the definition of wages, a payment must also meet the requirements set forth in whichever revenue rulings happen to be in effect at the time the payment is made.

The Government argues that Congress was simply being over-inclusive in drafting Section 3402(o). According to the Government, when Congress indicated that it was extending income tax withholding to payments "other than wages," what it really meant to say was that the section applied to both wage and non-wage payments. Br. 28. And when Congress directed that SUB payments should be treated "as if [they] were a payment of wages," what it really meant to say was that income tax should be withheld "*whether or not* [the payments] would otherwise be 'wages.'" *Id.* (emphasis in original). There are at least three distinct problems with the Government's proposed interpretation.

*First*, the interpretation lacks any grounding in the language of the statute. As this Court has many times explained, "in interpreting a statute a court should always turn first to one, cardinal canon before all others. We have stated time and again that courts

must presume that a legislature says in a statute what it means and means in a statute what it says there." *Connecticut Nat'l Bank v. Germain*, 503 U.S. 249, 253-54 (1992). Nothing in the statute suggests that Congress, when it described SUB payments as "other than wages," actually meant something quite different: that only some SUB payments are "other than wages" while others actually are wages. Nor is there any evidence in the statutory language that in mandating the treatment of a SUB payment "*as if* it were a payment of wages," Congress actually meant that some SUB payments actually *are* wages.

The issue of construction here is analogous to that addressed by the Court in *National Federation of Independent Business v. Sebelius,* 132 S. Ct. 2566 (2012). In that case, the Court considered whether assessable penalties were included in the IRC's definition of the term "tax" or merely treated in some instances *as if they were* taxes – leading to the negative inference that they were not, in fact, taxes. The Court observed:

> There would, for example, be no need for § 6671(a) to deem "tax" to refer to certain assessable penalties if the Code already included all such penalties in the term "tax." Indeed, amicus's earlier observation that the Code requires assessable penalties to be assessed and collected "in the same manner as taxes" makes little sense if assessable penalties are themselves taxes.

132 S. Ct. at 2584. Just as the language "in the same manner as taxes" indicates that assessable penalties are not actually taxes themselves, so too does the language "as if it were a payment of wages" indicate that SUB payments are not actually wages themselves.

*Second*, if Congress had meant to indicate that some of the payments described as "other than wages" actually *were* wages, it plainly knew how to do so. Section 3402(o) extends income tax withholding to sick pay, which may or may not constitute wages depending on whether the payments are made by an employer or by a third party, such as an insurer. *See* S. Rep. No. 96-1033 at 11 (1980) ("[N]o tax is specifically required to be withheld upon any wage continuation payment made by a person who is not the employer.") Congress clearly recognized that distinction by drafting Section 3402(o)(1)(C) to apply to any "payment to an individual of sick pay *which does not constitute wages*" (emphasis added). By contrast, neither subparagraph (A) (SUB payments) nor subparagraph (B) (annuity payments) distinguishes between wages and non-wages, demonstrating that all SUB payments under subparagraph (A) and all annuities under subparagraph (B) of Section 3402(o)(1) are non-wages.[4]

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[4] When Section 3402(o) was enacted, retirement plan annuities were expressly excluded from the definitions of wages under Chapters 21 and 24. *See* 26 U.S.C. §§ 3401(a)(12)(B) and

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Congress obviously knew how to write a provision that encompasses a type of payment that could be both a wage and a non-wage and it did not do so when describing SUB payments. Since Congress differentiated between wage and non-wage sick pay, but drew no such distinction with respect to SUB payments, the reasonable conclusion is that *all* SUB payments – unlike sick pay – are outside the scope of "wages." *Cf. Russello v. United States*, 464 U.S. 16, 23 (1983) ("[Where] Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." (internal quotation marks omitted)); *see also In re Griffith*, 206 F.3d 1389, 1394 (11th Cir. 2000) (*en banc*) (noting that "where Congress knows how to say something but chooses not to, its silence is controlling" (internal quotation marks omitted)).

*Third*, the Government's position violates another basic rule of statutory interpretation because it renders Section 3402(o) – to the extent it would apply, as the Government argues, to SUB payments that allegedly are wages – entirely superfluous. "It is 'a cardinal principle of statutory construction' that 'a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant.' . . .

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3121(a)(5)(B) (1964). Those exclusions remain in the statute today.

We are 'reluctant to treat statutory terms as surplusage in any setting,'. . . ." *TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001) (citations omitted).

Rather than interpreting Section 3402(o), as the Government urges, in such a way that makes it mere surplusage in all but the rare instances that a SUB payment comports with the requirements that the IRS seeks to impose through its revenue rulings, the better-supported interpretation is that Congress actually meant what it said – *all* SUB payments, without distinction, are something "other than wages."

### C. The Legislative History Confirms that SUB Payments Are Not Wages

Quality Stores is mindful of the Court's instruction that "when the language of the statute is plain, legislative history is irrelevant." *Zedner v. United States*, 547 U.S. 489, 510 (2006) (Scalia, J., concurring in part and concurring in the judgment) (citing *United States v. Gonzales*, 520 U.S. 1, 6 (1997)). IRC Sections 3401 and 3402 make it unambiguously clear that SUB payments do not come within the definition of "wages."

However, if the Court were to consider the legislative history, a review of that history provides strong support for the conclusion that SUB payments are not remuneration for services and are not wages. *Cf. Milavetz, Gallop & Milavetz, P.A. v. United States*, 559 U.S. 229, 236 n.3 (2010) ("Although reliance on

legislative history is unnecessary in light of the statute's unambiguous language, we note the support that record provides for the [respondent's] reading."). The legislative history of Section 3402(o) explicitly provides that SUB payments are not wages:

> Present law. – Under present law, supplemental unemployment benefits are not subject to withholding *because they do not constitute wages or remuneration for services.*
>
> General reasons for change. – Supplemental unemployment compensation benefits . . . paid by employers are generally taxable income to the recipient. Consequently, the absence of withholding on these benefits may require a significant final tax payment by the taxpayer receiving them. The committee concluded that although these benefits are not wages, since they are generally taxable payments they should be subject to withholding to avoid the final tax payment problem for employees.

S. Rep. No. 91-552 at 268 (1969), reprinted in 1969 U.S.C.C.A.N. 2027, 2305-06 (emphasis added). The Senate Finance Committee Report concluded that "[t]he withholding requirements applicable to withholding on wages are to apply to these *nonwage payments*." *Id.* at 2306 (emphasis added).[5]

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[5] Although these statements, as the Government points out, were made after the enactment of the definition of "wages" in the Internal Revenue Code, Br. 25, they nonetheless shed light

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Indeed, the Government's Brief cites testimony given by the Treasury Department before Congress that confirms that in 1969 the Treasury Department considered all SUB payments to be non-wages. Advising Congress about an earlier version of what ultimately became Section 3402(o), the Treasury Department testified that

> . . . the Treasury recommends the inclusion in the bill of provisions which could authorize the promulgation of regulations prescribing conditions for voluntary income tax withholding with respect to amounts paid for services *which are not "wages" as defined in section 3401* of the Code . . . This would simplify income tax payment for . . . recipients of payments under *supplemental unemployment benefit (SUB) plans*. . . .

Statements and Recommendations of the Department of the Treasury: Hearings on H.R. 13270 Before the Senate Comm. on Finance, 91st Cong. 1st Sess. 905 app. (1969) (emphasis added) (cited in Br. 32). It is plain from this testimony that the Treasury Department believed that payments under SUB plans were "not 'wages' as defined in section 3401" of the IRC.

Notwithstanding the Treasury Department's own congressional testimony to the contrary noted above, the Government now contends that the Senate

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on the state of the "present law" that gave rise to the need for, and subsequent enactment of, Section 3402(o) in 1969.

Finance Committee Report's reference to "present law" was not in fact a statement of the general status of SUB payments as non-wages within the basic meaning of the statute, but rather an "imprecise" allusion to the IRS' prior revenue rulings, which exempted certain SUB payments, meeting requirements chosen by the IRS, from the definition of "wages." Br. 35-36. This interpretation, however, fails to explain the Senate Finance Committee Report's statement that SUB payments not only are not "wages," but also are not "remuneration for services." Since there was no IRS revenue ruling opining that SUB payments were not "remuneration for services," the Report could not have been alluding thereby to a revenue ruling. Moreover, the Government offers no explanation why the Report should be deemed to refer to agency opinions, which lack the force and effect of law, as "present law."

It is apparent, instead, that by "present law" the Senate Finance Committee was referring to the statutory definition and Treasury regulations then in effect relating to SUB payments. In 1960, Congress amended the IRC to provide an income tax exemption for trusts established to make SUB payments. Pub. L. No. 86-667, 74 Stat. 534 (1960). In doing so, Congress defined SUB payments as "benefits which are paid to an employee because of his involuntary separation from the employment of the employer (whether or not such separation is temporary) resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions. . . ." 74 Stat.

535. This same definition remains in the statute today, and was imported almost verbatim into Section 3402(o)(2)(A). 26 U.S.C. §§ 501(c)(17)(D), 3402(o)(2)(A).

The Treasury Department's regulations adopted in 1968, shortly before the enactment of Section 3402(o), demonstrate that, under then-"present law," SUB payments were not deemed wages for any tax purposes. Those Treasury regulations required any SUB payments of $600 or more to be reported on Form 1099 – a reporting form that cannot be used to report an employee's wages for income tax withholding or FICA purposes. *See* Treas. Reg. §§ 1.501(c)(17)-2(j) (as amended in 1970) and 1.6041-2(b) (as amended in 2004); T.D. 6972, 1968-2 C.B. 222, 229 and 239; 33 Fed. Reg. 12,899 (Sept. 12, 1968). Thus, the Treasury Department implicitly recognized that SUB payments were not wages.[6]

If any SUB payments were wages (as the Government now claims), then reporting them on Form 1099 would have been impermissible. Thus, the IRS regulatory structure, which remains in effect today,

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[6] Shortly after Section 3402(o) was enacted, Treasury Regulation Sections 1.501(c)(17)-2(j) and 1.6041-2(b) were amended to provide that Form W-2 reporting would replace Form 1099 reporting for SUB payments made after December 31, 1970 that were subject to federal income tax withholding under Section 3402(o). *See* Treas. Reg. § 1.501(c)(17)-2(j); T.D. 7068, 1970-2 C.B. 252; 35 Fed. Reg. 17,328 (Nov. 11, 1970). However, this change – driven by Section 3402(o)'s requirement that SUB payments be treated "as if" they were wages – does not change the essential nature of such payments as recognized in the original 1968 Regulation.

confirms that under the "present law" at the time Section 3402(o) was enacted – which remains "present law" today – SUB payments were not and are not wages. Thus, the Government's contention that "[T]he 1969 Congress could not reasonably have believed that *all* of the payments it defined as 'supplemental unemployment compensation benefits' fell outside the existing statutory definition of 'wages'" (Br. 25) (emphasis in original), is contradicted not only by the IRC but also by the Treasury Department's own congressional testimony and regulations.

### D. The Government's Insistence that "Dismissal Payments" Are Wages Is Irrelevant to the Issue Before the Court

The Government argues at length that since "dismissal payments" and other "termination-related payments" constitute wages within the statutory definition, and have historically been treated by the IRS as wages, SUB payments must also be wages. Br. 8, 16-17, 23-24, 34-36. There is a logical gap in that argument: It presumes, incorrectly, that "dismissal payments" and "SUB payments" are synonymous. Plainly, they are not.

SUB payments are defined as amounts paid pursuant to an employer plan, on account of an involuntary separation resulting directly from a reduction in force, discontinuance of a plant or operation or other similar conditions. There are no similar requirements for dismissal pay, which simply requires

an involuntary separation. Thus, for example, payments to employees fired for cause would be dismissal payments, while payments made pursuant to an employer plan to employees on layoff status are SUB payments.

The Government's attempt to conflate dismissal payments with SUB payments is directly contradicted by the Treasury regulations, which clearly recognize a distinction between the two types of payments. Treasury Regulation Section 31.3401(a)-1(b)(4) defines dismissal payments as payments made "on account of . . . involuntary separation from the service of the employer . . . regardless of whether the employer is legally bound by contract, statute, or otherwise to make such payments." Under the regulation, dismissal payments constitute wages subject to income tax withholding. *Id.*

By contrast, Treasury Regulation Section 31.3401(a)-1(b)(14), effectuating IRC Section 3402(o), defines SUB payments in the same manner as the statute, as payments made "pursuant to a plan to which the employer is a party, because of the employee's involuntary separation . . . but only when such separation is one resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions." Treas. Reg. § 31.3401(a)-1(b)(14)(ii) (as amended in 2003). The regulation provides that SUB payments "shall be treated . . . *as if they were wages*, to the extent such benefits are includible in the gross income of such individual." *Id.* (emphasis added); Treas. Reg. § 1.6041-2(b) (as

amended in 2004). Obviously, even the IRS does not believe that dismissal payments are synonymous with SUB payments, or it would have had no need to promulgate separate regulations to address each of them.

There are good public policy reasons for treating SUB payments – which are intended to supplement unemployment compensation benefits – differently from other termination-related payments. As both the court of appeals in this case and the Federal Circuit court of appeals pointed out in *CSX Corp. v. United States*, 518 F.3d 1328 (Fed. Cir. 2008), it is important that SUB payments not be characterized as wages to avoid causing the loss of eligibility for state unemployment benefits, which "would largely defeat the purpose of supplemental unemployment benefits." *Id.* at 1335. The Government's proposed treatment of SUB payments as wages could adversely impact the underlying purpose of providing such benefits. It could also distort the statutory framework for unemployment benefits and extended unemployment benefits eligibility set up between the federal government and state governments, since the provisions for extended unemployment benefits expressly incorporate the statutory definition of SUB payments (26 U.S.C. § 501(c)(17)) into their eligibility requirements. *See, e.g.,* 26 U.S.C. § 3304(a)(11) and § 202(a)(3)(D) of the Federal-State Extended Unemployment Compensation Act of 1970, Pub. L. No. 91-373, 84 Stat. 708 (1970), as amended by Pub. L. No. 96-499, 94 Stat. 2659 (1980).

Further, as the district court below explained:

> The statutory enactments make clear that at some point a line is to be drawn on the taxation of employee financial benefits; otherwise, the benefits become the basis of the very taxes collected to return as benefits. That is, at one end of the spectrum are social security benefits and at the other end of the spectrum are wages/earnings, and at the point on the spectrum where severance payments are intended to serve the same purpose as social security benefits, i.e., support for workers in lieu of a lost ability to earn wages, the collection of social benefit taxes on the wage-replacement benefits makes little sense.

Pet. App. 48a-49a.

In short, the Government's argument that dismissal payments are wages is nothing but a red herring. The fact that *some* dismissal payments may constitute wages under the statutory definition does not mean that *any* SUB payments, as defined by the IRC, constitute wages under that definition. Rather, in accordance with the plain language of the statute, whether a payment constitutes "wages" must be determined by a factual review of whether it is "remuneration for services." 26 U.S.C. § 3401. In this case, the facts stipulated to by the parties show that the Payments made by Quality Stores were not remuneration for services.

### E. This Court's Ruling in *Coffy* Strongly Supports the Conclusion that SUB Payments Are Not Wages

The only case in which this Court previously has considered the nature of SUB payments (albeit in a different context), is *Coffy*. In *Coffy*, the petitioner-employee, after being honorably discharged from the military, applied to his former employer for reinstatement. 447 U.S. at 193. Because the employer was in the process of laying off employees, the petitioner was reinstated in layoff status. *Id.* The issue that arose was the level of supplemental unemployment benefits to which the petitioner was entitled. Should he receive SUB payments based on credits for the work he actually performed, or was he entitled to SUB payments based on the credits he would have earned absent his service in the military? *Id.* The answer to that question turned on the nature of the SUB payments themselves, and whether they were intended to be a form of compensation for services rendered, or were a means of providing economic security during periods of layoff to employees who had been in the service of the employer for a significant period. *Id.* at 200.

In analyzing the nature of SUB payments, the Court held that such payments "cannot be compensation for work performed." *Id.* at 200. Rather, "they are contingent on the employee's being thrown out of work; unless the employee is laid off he will never receive SUB payments. In this sense, SUBs are analogous to severance payments: they are 'compensation

for loss of jobs.'" *Coffy*, 447 U.S. at 200 (citations omitted). "From the beginning . . . the purpose of SUB plans was to provide employment security regardless of the hours worked rather than to afford additional compensation for work actually performed." *Id.* In other words, while SUB payments are analogous to severance payments, they are not severance payments, nor are they dismissal payments. Rather, SUB payments are a separate and unique category of payment expressly defined by statute and subject to specific rules and regulations.

This Court's holding in *Coffy* that SUB payments do not constitute "compensation for work performed" is consistent with Congress' view, expressed in Section 3402(o), that SUB payments are not "wages." This holding is in no way undermined by the fact that a payment may constitute "remuneration" regardless of the "name by which [it] is designated," "the basis upon which [it] is paid," or "the medium in which [it] is paid." Br. 11 (citing Treas. Reg. §§ 31.3121(a)-1(c)-(e) (as amended in 2003)). There is no question that the definition of "remuneration" is broad. The issue is not whether SUB payments are remuneration, but whether they are remuneration for the employee's services or employment – as opposed to payments on account of the elimination of that employment.

### F. This Court's Decisions in *Nierotko*, *Otte* and *Mayo* Are Distinguishable and Do Not Support a Finding that SUB Payments Are Wages

The Government contends that excluding SUB payments from the definition of wages conflicts with this Court's broad view of that term, relying primarily on the Court's decision in *Nierotko*. Br. 8, 11-12, 19. That case is distinguishable.

*Nierotko* involved an issue of "back pay," which is quite different, in purpose and practice, from supplemental unemployment compensation benefits. Unlike SUB payments, back pay is a form of reparation "based upon the loss of wages which the employee has suffered from the employer's wrong." *Id.* at 364. Back pay is awarded upon the employee's being reinstated in his employment, and is calculated based on the lost wages that he would have earned with the employer but for the unlawful discharge, less any net earnings during the time between discharge and reinstatement. *Id.* at 364-65. In short, "back pay," as analyzed in *Nierotko*, is simply the pay that the employee should have received earlier, paid at a later date. Had the employee received the pay when he should have, there is no question that it would have constituted "wages." The Court declined to reach a contrary conclusion simply because the payments were made retroactively.

The Government makes much of the fact that this Court, in *Nierotko*, read the phrase "service performed" broadly to include "not only work actually done but the entire employer-employee relationship for which compensation is paid to the employee by the employer." Br. 18-19 (citing 327 U.S. at 365-66). In the Government's view, this phrase is proof positive that virtually any payment made by an employer to a current or former employee must be "wages."

However, this key phrase must be read in context. Just before it, the Court noted that Nierotko, whom the National Labor Relations Board had reinstated, remained legally employed during the time period for which the employer was required to pay him "back pay." *Id.* at 365. The fact that Nierotko still had "employment" that met the Social Security Act's definition was the key to the Court's determination that Nierotko's back pay constituted "wages":

> Since Nierotko remained an employee under the definition of the Labor Act, although his employer had attempted to terminate the relationship, he had "employment" under that Act and we need consider further only *whether under the Social Security Act its definition of employment, as "any service . . . performed . . . by an employee for his employer," covers what Nierotko did for the Ford Motor Company.*

*Id.* at 365 (emphasis added).

Because of the Labor Act, Nierotko's employer's attempt to terminate the employment relationship

failed; the employer-employee relationship continued after the improper discharge and Nierotko continued to have "employment" despite the fact that he was not actually doing work. In this context, it is clear that the Court's admonition that "service performed" encompasses "the entire employer-employee relationship" merely reflects the fact that, so long as Nierotko was still employed, his "employment" met the definition in the Social Security Act (which is the same as FICA's "employment" definition), and payments from his employer were his "wages," whether or not he actually worked for them.

Quality Stores did not make SUB payments to its former employees in the context of an ongoing employer-employee relationship, nor did the employees legally continue to have "employment." To the contrary, the Payments – like the payments in *Coffy* – were compensation for the *loss* of employment.

This conclusion is not altered by the Court's decision in *Otte v. United States*, 419 U.S. 43 (1974). Although the Government cites *Otte* for the proposition that "[p]ayments may be 'wages' under FICA 'even though * * * at the time of payment, the employment relationship * * * no longer exists,'" that case is completely inapposite. Br. 13 (citing 419 U.S. at 51). The issue in *Otte* was whether unpaid ordinary-course wages owed to former employees for *services performed while they were still employed* were exempt from federal income tax withholding and FICA taxes merely because the payments were made by a bankruptcy trustee instead of the employer. *Id.* at 49. This

Court held that the original character of the payments as wages was not altered by the fact that the trustee, rather than the employer, was the payor. *Otte*, 419 U.S. at 49-50. Unlike the payments for services performed in *Otte*, the SUB payments at issue here were never wages in the first place.

The Government also cites the Court's decision in *Mayo Found. for Med. Educ. & Research v. United States*, 131 S. Ct. 704 (2011), in which the Court referenced the broad scope of the term wages. *Id.* at 709. *Mayo* involved stipend payments made to medical residents. There was no dispute in that case that the payments were remuneration for services performed by the residents and thus met the statutory definition of "wages." *Id.* at 708-09. Unlike the issue here, the question in *Mayo* was whether the payments came within a specified exception to "wages" – not whether they were within the definition of "wages" in the first instance. Thus, *Mayo*, like *Otte*, is irrelevant to the question of whether SUB payments are within the basic statutory definition of wages.

SUB payments, by contrast to the payments made in *Nierotko*, *Otte* and *Mayo*, are neither make-whole compensation paid in the context of a continuing employment relationship nor wages for services actually performed. *Coffy*, not *Nierotko, Otte* or *Mayo*, provides the proper framework for analyzing whether SUB payments are "wages," and *Coffy* indicates that they are not. The Government's application of *Nierotko* is seriously flawed in any case. Taken to its logical conclusion, that application posits that any

payment made by an employer to a current or former employee arises out of the employer-employee relationship and therefore constitutes wages. Yet this is clearly not the case. As the Government must and does concede, at least some SUB payments – payments made by employers to former employees – do *not* constitute wages. Br. 28.

## II. The Internal Revenue Code Defines "Wages" Substantially Identically for Income Tax Withholding and FICA Taxation Purposes, and Therefore Must Be Construed *In Pari Materia*

As explained above, the statutory language, legislative history and the Treasury Department's own testimony make it clear that all payments qualifying as SUB payments, as defined in IRC Section 3402(o), are not wages for purposes of income tax withholding as defined by Section 3401(a). The parties have stipulated to facts demonstrating that all of the Quality Stores Payments fall within the statutory definition of SUB payments in Section 3402(o)(2)(A). The only issue, then, is whether SUB payments are non-wages not only for purposes of income tax withholding, but also for purposes of FICA taxation.

### A. The Definitions of "Wages" Under Section 3121 (FICA Taxation) and Section 3401 (Income Tax Withholding) Are Substantially Identical

The IRC defines the term "wages" substantially identically for purposes of both FICA taxation and income tax withholding:

| **Section 3121(a)** | **Section 3401(a)** |
|---|---|
| For purposes of this chapter, the term "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash; . . . | For purposes of this chapter, the term "wages" means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash; . . . |

26 U.S.C. §§ 3121(a), 3401(a).

Section 3121(b), in turn, defines "employment" for FICA taxation purposes as "any service, of whatever nature, performed by an employee for the person employing him. . . . ," thereby completing the parallel between the two sections defining "wages." *See* 26 U.S.C. § 3121(b)(A). This Court recognized the identical nature of the two definitions in *Rowan*, 452 U.S. at 255 (1981) (noting that Congress chose to define the term "wages" for income tax withholding purposes

in "substantially the same language that is used in FICA. . . .").

Despite Congress' use of substantially the same language to define "wages" under both Chapter 21 and Chapter 24, the Government attempts to distinguish the two definitions. The Government notes that FICA contains many express exclusions from the definition of "wages" and suggests that, absent an express exclusion, Section 3121(a) should be read broadly to include SUB payments as wages. Br. 15. The Government points in particular to Section 3121(a)(13), which

> excludes from the statutory definition of "wages" a limited subset of termination-related payments, namely, certain types of disability payments made "upon or after the termination of an employee's employment relationship because of * * * retirement for disability." 26 U.S.C. 3121(a)(13)(A).

Br. 15. The Government argues that "[S]uch an exception would have been unnecessary if the basic definition of 'wages' did not cover termination-related payments at all." *Id.*

This argument misstates Quality Stores' position. Quality Stores does not contend that the basic definition of "wages" does not cover termination-related payments at all; it clearly does. But just as Section 3121(a)(13) shows that *some* termination-related payments are wages (otherwise there would be no need for the exception), it similarly demonstrates that

SUB payments are *not* wages. If – as the Government implies – all termination-related payments not covered by Section 3121(a)(13)'s limited exception must fit the definition of wages by default, there would have been no need for Congress to enact Section 3402(o), since SUB payments would already have been wages and thus subject not only to FICA taxation but to income tax withholding.

Furthermore, the nearly identical definition of "wages" in the federal income tax withholding provision, IRC Section 3401(a), similarly contains a long list of exclusions that does not include SUB payments. Yet the Government concedes that at least some SUB payments clearly are considered by Congress to be non-wages for income tax withholding purposes. Br. 28. Thus, whether SUB payments are among the enumerated statutory exceptions to the definition of "wages" clearly cannot be determinative of their status for either income tax withholding or FICA taxation.

### B. Under *Rowan*, "Wages" Must Be Given the Same Meaning for Income Tax Withholding and FICA Taxation Purposes

The threshold question of whether a payment is "remuneration for employment" or "remuneration for services," and thus "wages," should be determined consistently for both FICA tax and income tax withholding purposes.

In *Rowan*, the Court considered whether the definition of "wages" under FICA and the Federal Unemployment Tax Act ("FUTA") included the value of meals and lodging provided to employees working on the Rowan Companies' offshore oil rigs. 452 U.S. at 249. Pursuant to the Treasury regulations in effect at the time, the IRS included the fair value of these meals and lodging in "wages" for purposes of FICA and FUTA tax withholding, but not for income tax withholding purposes. *Id.* The Treasury regulations prescribed this practice notwithstanding the fact that Congress defined the term "wages" in "substantially identical language for each of these three obligations upon employers." *Id.*

Based on the nearly identical definitions of "wages" in the three statutes, this Court concluded that "Congress intended 'wages' to mean the same thing under FICA, FUTA, and income-tax withholding." *Id.* at 255. The Court found that the statutory scheme was born out of "congressional concern for 'the interest of simplicity and ease of administration.'" *Id.* (citations omitted). The Court further found that "[i]t would be extraordinary for a Congress pursuing this interest to intend, without ever saying so, for identical definitions to be interpreted differently." *Id.* at 257. Therefore, the Court held that the Treasury regulations were invalid, because they "fail[ed] to implement the statutory definition of 'wages' in a consistent or reasonable manner." *Id.* at 263.

As noted above, Congress specifically stated in the legislative history to Section 3402(o) that SUB payments "do not constitute wages or remuneration for services." S. Rep. No. 91-552 at 268 (1969), reprinted in 1969 U.S.C.C.A.N. 2027, 2305-06. Under *Rowan*, the statutory definition of wages must be implemented consistently for both income tax withholding (Chapter 24) and FICA taxation (Chapter 21). Thus, payments that are not "remuneration . . . for services" (Chapter 24) cannot be "remuneration for . . . any services performed by an employee" (Chapter 21), and SUB payments are not "wages" under either chapter.

It is irrelevant to the *Rowan* analysis that Congress has chosen for policy reasons to treat SUB payments *as if they are wages* for income tax withholding purposes. Such payments are subject to income tax withholding not because they are wages, but because they are taxable income. To do otherwise would expose terminated employees to a heavy final tax burden when they file their tax returns. Congress did not, however, choose to treat SUB payments as if they are wages for FICA tax purposes, because there is no corresponding policy reason for doing so. Accordingly, such amounts are not subject to FICA taxes.

### C. The Government's Arguments for Distinguishing the Definition of Wages Under FICA from the Definition of Wages for Income Tax Withholding Are Without Merit

#### 1. Section 3402(o) Did Not Alter the Definition of "Wages" But Rather Recognized the State of the "Present Law"

Attempting to separate the definition of wages under FICA from the definition of wages for income tax withholding, despite this Court's clear holding in *Rowan*, the Government sets up a straw man, arguing that

> [i]t would be even more implausible to construe Section 3402(o) as an affirmative effort by Congress to narrow the pre-existing definition of "wages." . . . If Congress had intended either to limit Chapter 24's definition of "wages," or to eliminate FICA tax for the sorts of dismissal payments historically treated as "wages" under FICA, the language it used in Section 3402(o) would have been a remarkably oblique way of accomplishing that result.

Br. 36.

This misstates both the plain language and legislative history of Section 3402(o). In enacting Section 3402(o), Congress did not alter the pre-existing definition of "wages" but rather recognized the state of the "present law" as to that definition –

specifically, that SUB payments (as defined in Section 501(c)(17)(D)) were neither wages nor remuneration for services. S. Rep. No. 91-552 at 268 (1969), reprinted in 1969 U.S.C.C.A.N. 2027, 2305-06. As both Congress and the Treasury Department recognized, payments made pursuant to an employer plan to employees involuntarily terminated due to reductions in force or plant closings were *already* outside of the definition of wages. Thus, there was no need to narrow that definition. The only thing that Congress attempted to accomplish through the passage of Section 3402(o) was the amelioration of any surprise tax burden caused by the pre-existing fact that SUB payments, though not wages subject to withholding, were nonetheless taxable income.

Still arguing against the false premise that Section 3402(o) is being used to try to narrow the definition of wages, the Government contends that

> [b]y its terms, Section 3402(o) is irrelevant to the FICA definitional provisions at issue in this case. The prefatory language of Section 3402(o)(1) states that the rules therein – including the rule that "supplemental unemployment compensation benefits" shall be treated as "wages" for purposes of income-tax withholding – apply "(f)or purposes of this chapter (and so much of subtitle F as relates to this chapter)." Section 3402(o)(1) thus applies only to Chapter 24 (income-tax withholding) and those portions of Subtitle F (matters of procedure and administration) that relate to Chapter 24. FICA, by contrast,

> is codified at Chapter 21 of the Internal Revenue Code.

Br. 22-23.

The Government's argument, once again, is wide of the mark. Section 3402(o)'s requirement that SUB payments be treated as if they are wages is limited to Chapter 24 simply because there is no need to treat them as if they were wages for any purpose other than income tax withholding. Accordingly, Congress explicitly established that SUB payments should only be treated as if they were wages for the limited purpose of ensuring that sufficient tax is withheld from non-wage taxable income. This is bolstered by Section 3402(o)'s directive that SUB payments be treated as "a payment of wages by an employer to an employee for a payroll period." As the Government admits, "payroll period" is relevant to the calculation of income tax to be withheld, but has no analog in FICA. Br. 24-25. It is thus clear that SUB payments are to be treated as wages *only* for purposes of income tax withholding. For all other purposes, including FICA, SUB payments continue to be treated as the non-wages that they are.

The Government has identified no basis on which the Court should ignore the longstanding precedent it set in *Rowan* and instead construe wages differently for income tax withholding and FICA taxation purposes. Before the court of appeals and the lower courts in this case, as well as before the Federal Circuit court of appeals in *CSX* (518 F.3d at 1343),

the Government argued that this Court's holding in *Rowan* was legislatively overruled by the so-called "decoupling amendment" contained in the Social Security Amendments of 1983, Pub. L. No. 98-21, § 327(b)(1), 97 Stat. 65 (1983) (the "Decoupling Amendment"). The Decoupling Amendment revised the definitional section of FICA, § 3121(a), to provide that

> [n]othing in the regulations prescribed for purposes of chapter 24 (relating to income tax withholding) which provides an exclusion from "wages" as used in such chapter shall be construed to require a similar exclusion from "wages" in the regulations prescribed for purposes of this chapter [Chapter 21 relating to FICA taxes].

26 U.S.C. § 3121(a).

The Government appears to have abandoned the argument that the Decoupling Amendment overruled *Rowan*, and for good reason. The argument was rejected by both the Sixth Circuit and the Federal Circuit courts of appeals (*see* Pet. App. 14a-17a; *CSX*, 518 F.3d at 1344), and suffers from at least two fatal flaws. First, the Decoupling Amendment provides for varying treatment of exclusions from wages for purposes of FICA and income tax withholding only through the promulgation of regulations. *Id.*; *see also CSX*, 518 F.3d at 1343-44. It says nothing at all about the threshold question addressed by *Rowan* – that is, whether a particular payment is wages for FICA tax or income tax purposes in the first place. *See CSX*, 518 F.3d at 1344 (noting that the language of the

Decoupling Amendment "addresses the construction of the regulations rather than chapter 24 itself; . . . it does not state that the term 'wages' in section 3401 will be defined independently from the term 'wages' in section 3121").

Second, the Decoupling Amendment, by its own terms, provides for the *exclusion* of payments from wages through the promulgation of regulations. It does not – at least on its face – provide for the *inclusion* of non-wage payments in the definition of wages. Thus, if a payment (such as a SUB payment) does not fall within the definition of wages for income tax withholding purposes, it is not at all clear that the Treasury Department could, through regulations, include such payments as wages for FICA purposes. In any event, it is undisputed that the Treasury Department has not issued such a regulation.

### 2. The Government's Position that SUB Payments Must Meet the Revenue Rulings' Definition Is Wrong

The parties before the Court agree on one thing: At least some SUB payments are not wages within the statutory definition. The Government concedes that

> Section 3402(*o*) does appear to reflect Congress's belief that *some* of the payments encompassed by the statutory definition of 'supplemental unemployment benefits' would not otherwise be viewed as 'wages' for

> purposes of income-tax withholding. The provision would have served no useful purpose if *all* such payments were already subject to the income-tax withholding that the provision requires.

Br. 28 (emphasis in original).

After that point, however, the parties diverge. Quality Stores' position – consistent with the "present law" described in the legislative history of Section 3402(o) – is that *no* SUB payments, as defined by Congress, are wages for purposes of income tax withholding or, pursuant to *Rowan*, for FICA taxation. The Government's argument to the contrary is underpinned by the implicit (and incorrect) presumption that this Court must defer to the opinions expressed in the IRS' revenue rulings.

The Government contends that the statutory definition of SUB payments enacted by Congress encompasses both wage and non-wage payments, and that only those payments meeting the IRS' current revenue ruling on SUB payments (or such conflicting rulings as the IRS may issue in the future) are non-wages for FICA purposes. Br. 17-18 ("A 1990 IRS Revenue Ruling concludes that FICA tax applies to severance payments unless, *inter alia*, the payments are 'linked to the receipt of state unemployment compensation.' Rev. Rul. 90-72, 1990-2 C.B. 211, 211. . . ."); *id.* at 28 ("The provision's history suggests that the payments Congress had in mind were the subset of 'supplemental unemployment compensation benefits' that the IRS had already determined, or

might later determine, to be 'income' but not 'wages.'").

Thus, the real question before the Court is which authority controls the determination whether a SUB payment constitutes "wages" – the statutory definition or the administrative opinion expressed by the IRS. As set forth in greater detail below, the statute must prevail.

### (a) Revenue Rulings Lack the Force and Effect of Law

Revenue rulings are no more than the opinions of the IRS, and lack the force and effect of law. *Dixon v. United States,* 381 U.S. 68, 73 (1965) (stating that "the [Internal Revenue] Commissioner's rulings have only such force as Congress chooses to give them, and Congress has not given them the force of law.").

As noted above, the IRS itself concedes that revenue rulings lack the force and effect of Treasury regulations. *See, e.g.,* Rev. Proc. 89-14, 1989-1 C.B. 814 (1989) ("Revenue rulings published in the Bulletin do not have the force and effect of Treasury Department regulations. . . ."). As discussed below, the fact that the revenue rulings lack the force of law determines the framework under which those rulings are evaluated by the Court.

### (b) Revenue Rulings Are Not Entitled to *Chevron* Deference

The Court has established at least two distinct frameworks for evaluating agency guidance. The more deferential framework is outlined by the Court's decisions in *Chevron,* 467 U.S. 837 and *United States v. Mead Corp.*, 533 U.S. 218 (2001).

*Chevron* (at least ostensibly) provides a two-step rule for determining the judicial deference to be accorded administrative interpretations. First, the Court considers whether Congress "has directly spoken to the precise question at issue." 467 U.S. at 842. If not, the Court then considers "whether the agency's answer is based on a permissible construction of the statute." *Id.* at 843. In *Mead*, the Court held that *Chevron* deference applies "when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority." *Id.* at 226-27.

Conversely, agency opinions and other pronouncements lacking the force of law are not entitled to any special deference under *Chevron* but rather are evaluated under the older power-to-persuade regime of *Skidmore*, discussed below. *Id.; see also Christensen v. Harris County,* 529 U.S. 576, 587 (2000) ("Interpretations such as those in opinion letters – like interpretations contained in policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law – do not warrant *Chevron*-style deference. . . .").

There is no question that the revenue rulings on which the Government relies are "opinions" issued without notice and comment procedures. They lack the force of law, and thus are not entitled to judicial deference. This is confirmed by the fact that the Government itself has not claimed any entitlement to judicial deference under *Chevron*.

### (c) These Revenue Rulings Lack Persuasive Power under *Skidmore*

Since the revenue rulings on which the Government relies are not entitled to judicial deference under *Chevron*, they must be evaluated based on their "power to persuade" under *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944).

In *Skidmore*, the Court explained that the weight given to an administrative interpretation of a statute "will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control." *Id.* at 140. The IRS' revenue rulings are neither consistent nor well-reasoned. As explained below, the IRS has twice changed its mind about whether a SUB payment must be linked to state unemployment benefits, and twice changed its mind about whether a SUB payment may be received in a lump sum. *See* Rev. Rul. 56-249, 1956-1 C.B. 488; Rev. Rul. 59-227, 1959-2 C.B. 13; Rev. Rul. 77-347, 1977-2 C.B. 362; Rev. Rul. 90-72, 1990-2 C.B. 211.

Moreover, the limited reasoning in Rev. Rul. 90-72, the revenue ruling on which the Government primarily relies, is superficial and conclusory. It fails to explain the basis for the position that SUB payments must be tied to state unemployment compensation benefits in order to be excluded from taxable wages for FICA purposes. Indeed, the IRS has never offered a cogent explanation for that position in any of its revenue rulings or other pronouncements. Thus, under *Skidmore*, the interpretation set forth in Rev. Rul. 90-72 is entitled to no special weight.

### (i) The IRS Has Repeatedly Changed Its Position in Its Revenue Rulings as to the Requirements for SUB Payments

The inconsistent and confusing history of the IRS' attempts to define SUB payments for FICA tax purposes began with the issuance of Rev. Rul. 56-249, 1956-1 C.B. 488. In that ruling, which, of course, was issued prior to the enactment of IRC Section 3402(o), the IRS opined that "benefits paid to former employees of M Company under the terms of the supplemental unemployment benefit plan do not constitute 'wages' for" FICA tax and income tax withholding purposes.[7] 1956-1 C.B. at 492. The ruling set forth

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[7] The IRS noted, however, that such amounts were taxable income to the former employees. 1956-1 C.B. at 492.

eight distinct conditions that the IRS regarded as significant in determining that the SUB payments were not wages, including, among others, (i) that the benefits were linked to the receipt of state unemployment benefits; (ii) that the benefits were based in part on the amount of straight-time weekly pay received by the employee while employed; (iii) that the benefits were not attributable to the rendering of particular services by the recipient during the period of his employment; and (iv) that the benefits were paid weekly and not in a lump sum. 1956-1 C.B. at 492.

Three years after its first revenue ruling on SUB payments, the IRS decided that whether a SUB payment was paid periodically or in a lump sum was not critical, after all, in excluding it from FICA taxation. In Rev. Rul. 59-227, the IRS applied the principles of Rev. Rul. 56-249 to plans that made lump-sum payments to employees and found that such payments also constituted non-wage SUB payments. 1959-2 C.B. 13.

After the enactment of Section 3402(o) – in which Congress declined to incorporate the majority of the IRS' complex criteria for non-wage SUB payments – the IRS changed its mind about whether payments needed to be tied to receipt of state unemployment benefits to qualify as non-wage SUB payments. In Rev. Rul. 77-347, the IRS opined that – contrary to its position in Rev. Rul. 56-249 – "the fact that benefits under the plan are *not* tied to the State's unemployment benefits is *not* a material or controlling factor." 1977-2 C.B. 362, 363 (emphasis added). Accordingly,

the IRS advised that separation-related payments that were not tied to state unemployment benefits nonetheless qualified as non-wage SUB payments for FICA taxation purposes. Rev. Rul. 77-347 expressly cites IRC Section 3402(o)'s definition of SUB payments.

In Rev. Rul. 90-72, 1990-2 C.B. 211, the IRS performed yet another about-face and proclaimed that

> [t]he portion of Rev. Rul. 77-347 concluding that benefits do not have to be linked to state unemployment compensation in order to be excluded from the definition of wages for FICA . . . tax purposes is inconsistent with the underlying premises for the exclusion and is therefore hereby revoked.

1990-2 C.B. at 212. The IRS further changed its mind (again) about whether SUB payments could be received in a lump sum, stating that lump-sum payments would no longer be excludable from wages. *Id.*

This Court has declined to give any special weight to administrative interpretations where those interpretations conflict with earlier pronouncements of the agency. *Gilbert*, 429 U.S. at 142-43. The fact that the IRS has changed its mind not once, but twice on what it contends are two critical elements for SUB payment eligibility robs the revenue rulings of any persuasive force they might have possessed. *Skidmore*, 323 U.S. at 140 (whether judicial deference should be given to an agency ruling depends, in part,

on the ruling's "consistency with earlier and later pronouncements").

Furthermore, the Government's arguments before this Court are inconsistent with the revenue rulings on which it relies. The Government argues that the Quality Stores Payments cannot qualify as non-wage SUB payments because they were based on the length of the employee's service with the companies and the level of the employee's regular compensation. Br. 8, 19. Yet Rev. Rul. 56-249 provides that benefits based in part on the duration of an employee's service with the employer and the level of the employee's regular compensation may be characterized as non-wage SUB payments. 1956-1 C.B. at 492. Similarly, Rev. Rul. 90-72 included the same factors for non-wage SUB payment eligibility articulated in Rev. Rul. 56-249, noting that "the amount of weekly benefits payable is based [in part] upon . . . the amount of straight-time weekly pay," and that "the duration of the benefits is affected by . . . the employee's seniority." 1990-2 C.B. at 212.

The Government neither acknowledges nor attempts to explain these inconsistencies. Thus, the fact that the Quality Stores Payments were based on the length of an employee's service and level of regular compensation is not inconsistent with the conclusion that the payments were SUB payments and not wages.

### (ii) The Revenue Rulings Are Not Well-Reasoned and Articulate No Sound Basis for Departing from the Plain Language of the Statute

When Congress enacted statutory provisions defining SUB payments in 1960 and again in 1969, it presumably was aware of the IRS' revenue rulings regarding SUB payments, yet did not adopt the revenue rulings' additional factors and limitations. Instead, Congress chose a simple and straightforward definition: SUB payments are "paid to an employee, pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment . . . resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions." 26 U.S.C. § 3402(o); *see also* 26 U.S.C. § 501(c)(17)(D). The IRS' revenue rulings seek to depart from the plain language of the statutes by layering on numerous additional requirements that SUB payments must meet, none of which Congress has ever adopted.

The IRS' revenue rulings can have no persuasive force without a credible explanation of their departure from the statutory definition of SUB payments. Yet the revenue rulings conspicuously fail to articulate their own reasoning. For example, Rev. Rule 90-72 mandates that benefits must be tied to state unemployment compensation benefits to be excluded from taxable wages, but offers no explanation why that should be the case. Nor has the Government in

its arguments to this Court attempted to provide such an explanation. In light of the fact that the only power the revenue rulings have before this Court is the power to persuade, the Government's failure even to attempt to defend the correctness of the revenue rulings on which it relies is telling.

The Federal Circuit court of appeals in *CSX* did not address whether the revenue rulings upon which the Government relies are substantively correct or whether there is legal authority for revenue rulings to determine the FICA treatment of particular benefit payments. Instead, the Federal Circuit simply accepted the Government's argument that because the appellees in *CSX* had not asserted that the benefit payments at issue met the requirements of the revenue rulings, the payments were taxable for FICA purposes.

When the proper analysis under *Skidmore* is performed, however, it is clear that the revenue rulings are not entitled to any weight. As a result, there is no basis for departing from the plain language of Section 3402(o), which sets forth the definition of SUB payments actually drafted by Congress, and no basis for overruling this Court's decision in *Rowan*, which provides for the consistent construction of "wages" across chapters of the Internal Revenue Code.

## CONCLUSION

For all the foregoing reasons, the decision of the court of appeals that the benefits paid by Quality Stores (i) constituted supplemental unemployment compensation benefits as defined in Section 3402(o) of the Internal Revenue Code, and (ii) are exempt from Federal Insurance Contributions Act taxes is correct and should be affirmed.

Respectfully submitted,

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## SUPPLEMENTAL APPENDIX

1. 26 U.S.C. Section 501(c)(17)(D) provides:

The term "supplemental unemployment compensation benefits" means only –

(i) benefits which are paid to an employee because of his involuntary separation from the employment of the employer (whether or not such separation is temporary) resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, and

(ii) sick and accident benefits subordinate to the benefits described in clause (i).

2. Treas. Reg. § 1.501(c)(17)-2(j) was amended by T.D. 6972, 1968-2 C.B. 222; 33 Fed. Reg. 12,899 (Sept. 12, 1968), to read in full as follows:

**Required Records and Returns.** Every trust described in section 501(c)(17) must maintain records indicating the amount of separation benefits and sick and accident benefits which have been provided to each employee. If a plan is financed, in whole or in part, by employee contributions to the trust, the trust must maintain records indicating the amount of each employee's total contributions allocable to separation benefits. In addition, every trust described in section 501(c)(17) which makes one or more payments totaling $600 or more in one year to an individual must file an annual information return in the manner described in paragraph (b)(1) of § 1.6041-2.

3. Treas. Reg. § 1.501(c)(17)-2(j) was further amended by T.D. 7068, 1970-2 C.B. 252; 35 Fed. Reg. 17,328 (Nov. 11, 1970), to read in full as follows (and it currently provides):

**Required Records and Returns.** Every trust described in section 501(c)(17) must maintain records indicating the amount of separation benefits and sick and accident benefits which have been provided to each employee. If a plan is financed, in whole or in part, by employee contributions to the trust, the trust must maintain records indicating the amount of each employee's total contributions allocable to separation benefits. In addition, every trust described in section 501(c)(17) which makes one or more payments totaling $600 or more in 1 year to an individual must file an annual information return in the manner described in paragraph (b)(1) of § 1.6041-2. However, if the payments from such trust are subject to income tax withholding under section 3402(o) and the regulations thereunder, the trust must file, in lieu of such annual information return, the returns of income tax withheld from wages required by section 6011 and the regulations thereunder. In such circumstances, the trust must also furnish the statements to the recipients of trust distributions required by section 6051 and the regulations thereunder.

4. Treas. Reg. § 1.6041-2(b)(1) provides:

**Distributions under employees' trust or plan.** (1) Amounts which are: (i) Distributed or made available to a beneficiary, and to which section 402 (relating to employees' trusts) or section 403 (relating

to employee annuity plans) applies, or (ii) Described in section 72(m)(3)(B), shall be reported on Forms 1096 and 1099 to the extent such amounts are includible in the gross income of such beneficiary if the amounts so includible aggregate $600 or more in any calendar year. In addition, every trust described in section 501(c)(17) which makes one or more payments (including separation and sick and accident benefits) totaling $600 or more in 1 year to an individual must file an annual information return on Form 1096, accompanied by a statement on Form 1099, for each such individual. Payments made by an employer or a person other than the trustee of the trust should not be considered in determining whether the $600 minimum has been paid by the trustee. The provisions of this subparagraph shall not be applicable to payments of supplemental unemployment compensation benefits made after December 31, 1970, which are treated as if they were wages for purposes of section 3401(a). Such amounts are required to be reported on Forms W-3 and W-2. See paragraph (b)(14) of § 31.3401(a)-1 of this chapter (Employment Tax Regulations).

5. Treas. Reg. § 1.6041-2(b)(1) was amended by T.D. 6972, 1968-2 C.B. 222; 33 Fed. Reg. 12,899 (Sept. 12, 1968), to read in full as follows:

**Distributions under employees' trust or under supplemental unemployment benefit trust.** (1) Amounts which are distributed or made available to a beneficiary, and to which section 402 (relating to employees' trusts) or section 403 (relating to

employee annuity plans) applies, shall be reported on Forms 1099 and 1096 to the extent such amounts are includible in the gross income of such beneficiary when the amounts so includible are $600 or more in any calendar year. In addition, every trust described in section 501(c)(17) which makes one or more payments (including separation and sick and accident benefits) totaling $600 or more in 1 year to an individual must file an annual information return on Form 1096, accompanied by a statement on Form 1099, for each such individual. Payments made by an employer or a person other than the trustee of the trust should not be considered in determining whether the $600 minimum has been paid by the trustee.

6. Treas. Reg. § 1.6041-2(b)(1) was further amended by T.D. 7068, 1970-2 C.B. 252; 35 Fed. Reg. 17,328 (Nov. 11, 1970), to read in full as follows (and it currently provides):

**Distributions under employees' trust or under supplemental unemployment benefit trust.** (1) Amounts which are distributed or made available to a beneficiary, and to which section 402 (relating to employees' trusts) or section 403 (relating to employee annuity plans) applies, shall be reported on Forms 1099 and 1096 to the extent such amounts are includible in the gross income of such beneficiary when the amounts so includible are $600 or more in any calendar year. In addition, every trust described in section 501(c)(17) which makes one or more payments (including separation and sick and accident benefits)

totaling $600 or more in 1 year to an individual must file an annual information return on Form 1096, accompanied by a statement on Form 1099, for each such individual. Payments made by an employer or a person other than the trustee of the trust should not be considered in determining whether the $600 minimum has been paid by the trustee. The provisions of this subparagraph shall not be applicable to payments of supplemental unemployment compensation benefits made after December 31, 1970, which are treated as if they were wages for purposes of section 3401(a). Such amounts are required to be reported on Form W-2. See paragraph (b)(14) of § 31.3401 (a)-1 of this chapter (Employment Tax Regulations).

7. Treas. Reg. §§ 31.3401(a)-1(b)(14)(i) and (ii) provide:

**Supplemental unemployment compensation benefits.** (i) Supplemental unemployment compensation benefits paid to an individual after December 31, 1970, shall be treated (for purposes of the provisions of Subparts E, F, and G of this part which relate to withholding of income tax) as if they were wages, to the extent such benefits are includible in the gross income of such individual.

(ii) For purposes of this subparagraph, the term "supplemental unemployment compensation benefits" means amounts which are paid to an employee, pursuant to a plan to which the employer is a party, because of the employee's involuntary separation from the employment of the employer, whether or not such

separation is temporary, but only when such separation is one resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions.

# REPLY BRIEF

No. 12-1408

# In the Supreme Court of the United States

UNITED STATES OF AMERICA, PETITIONER

*v.*

QUALITY STORES, INC., ET AL.

*ON WRIT OF CERTIORARI*
*TO THE UNITED STATES COURT OF APPEALS*
*FOR THE SIXTH CIRCUIT*

## REPLY BRIEF FOR THE PETITIONER

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## TABLE OF CONTENTS

Page

A. Respondents' severance payments are "wages" under FICA ..... 2
B. Section 3402(*o*) does not implicitly constrict FICA's definition of "wages" ..... 8

## TABLE OF AUTHORITIES

Cases:

*Adler* v. *Commissioner*, 330 F.2d 91 (9th Cir. 1964) ..... 16
*American Bank & Trust Co.* v. *Dallas Cnty.*, 463 U.S. 855 (1983) ..... 5
*Bilski* v. *Kappos*, 130 S. Ct. 3218 (2010) ..... 14
*Bruesewitz* v. *Wyeth LLC*, 131 S. Ct. 1068 (2011) ..... 18
*CSX Corp.* v. *United States*:
52 Fed. Cl. 208 (2002), rev'd, 518 F.3d 1328 (Fed. Cir. 2008) ..... 15
518 F.3d 1328 (Fed. Cir. 2008) ..... 9, 11
*Casa de La Jolla Park, Inc.* v. *Commissioner*, 94 T.C. 384 (1990) ..... 16
*Coffy* v. *Republic Steel Corp.*, 447 U.S. 191 (1980) ..... 4
*Environmental Def.* v. *Duke Energy Corp.*, 549 U.S. 561 (2007) ..... 9
*Green* v. *Commissioner*, 59 T.C. 456 (1972) ..... 16
*Mayo Found. for Med. Educ. & Research* v. *United States*, 131 S. Ct. 704 (2011) ..... 2
*National Fed'n of Indep. Bus.* v. *Sebelius*, 132 S. Ct. 2566 (2012) ..... 12
*Otte* v. *United States*, 419 U.S. 43 (1974) ..... 3
*Rowan Cos.* v. *United States*, 452 U.S. 247 (1981) ..... 9
*Social Sec. Bd.* v. *Nierotko*, 327 U.S. 358 (1946) ..... 2, 3, 4, 14
*United States* v. *Fausto*, 484 U.S. 439 (1988) ..... 14

Case—Continued: Page

*United States* v. *Woods*, No. 12-562 (Dec. 3, 2013) ..... 18

Statutes and regulations:

Act of Dec. 24, 1980, Pub. L. No. 96-601, § 4(a), 94 Stat. 3496 ..... 11
Federal Insurance Contributions Act, 26 U.S.C. 3101 *et seq.*:
26 U.S.C. 3121(a) (1964) ..... 14, 18
26 U.S.C. 3121(a) ..... 1, 2, 4
26 U.S.C. 3121(b) (1964) ..... 18
26 U.S.C. 3121(b) ..... 2
Federal-State Extended Unemployment Compensation Act of 1970, Pub. L. No. 91-373, 84 Stat. 708, as amended by the Omnibus Reconciliation Act of 1980, Pub. L. No. 96-499, 94 Stat. 2659 ..... 8
Social Security Act Amendments of 1939, ch. 666, § 606, 53 Stat. 1383-1384 ..... 5
Vietnam Era Veterans' Readjustment Assistance Act of 1974, Pub. L. No. 93-508, 88 Stat. 1578 ..... 4
26 U.S.C. 501(c)(17)(D) ..... 8, 16
26 U.S.C. 1426(a)(4) (1940) ..... 3
26 U.S.C. 3304(a)(11) ..... 8
26 U.S.C. 3401(a) (1964) ..... 18
26 U.S.C. 3402(*o*) ..... *passim*
26 U.S.C. 3402(*o*)(1) ..... 8, 13
26 U.S.C. 3402(*o*)(1)(A) ..... 12
26 U.S.C. 3402(*o*)(1)(C) ..... 11
26 U.S.C. 3402(*o*)(2)(A) ..... *passim*

Regulations—Continued: Page

26 C.F.R.:
Pt. 1:
Section 1.501(c)(17)-2(j) (1968) ..... 16
Section 1.6041-2(b)(1) (1968) ..... 16
Pt. 31:
Section 31.3121(a)-1(i) ..... 3
Section 31.3401(a)-1(b)(4) ..... 6, 15
Section 31.3401(a)-1(b)(4) (1968) ..... 16, 17
Section 31.3401(a)-1(b)(4) (1969) ..... 15
Section 31.3401(a)-1(b)(14) ..... 6

Miscellaneous:

Joseph M. Becker, *Guaranteed Income for the Unemployed: The Story of SUB* (1968) ..... 17
22 Fed. Reg. 8434 (Oct. 26, 1957) ..... 6, 15
35 Fed. Reg. 17,328 (Nov. 11, 1970) ..... 6
H.R. Rep. No. 1300, 81st Cong., 1st Sess. (1949) ..... 5, 6, 15
Rev. Rul. 56-249, 1956-1 C.B. 488 ..... 18
Rev. Rul. 58-128, 1958-1 C.B. 89 ..... 18
Rev. Rul. 60-330, 1960-2 C.B. 46 ..... 17, 18
Rev. Rul. 71-408, 1971-2 C.B. 340 ..... 15
Rev. Rul. 90-72, 1990-2 C.B. 211 ..... 7
S. Rep. No. 552, 91st Cong., 1st Sess. (1969) ..... 18
S. Rep. No. 221, 78th Cong., 1st Sess. (1943) ..... 9

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UNITED STATES OF AMERICA, PETITIONER

*v.*

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## REPLY BRIEF FOR THE PETITIONER

To ensure adequate funding for the Social Security and Medicare programs, the Federal Insurance Contributions Act (FICA) expansively defines taxable "wages" to include "all remuneration for employment," 26 U.S.C. 3121(a), subject to enumerated exceptions. Respondents acknowledge (Br. 41) that "termination-related payments"—that is, payments triggered by the conclusion of the employment relationship—can qualify as "wages" under that "basic definition." Respondents also acknowledge (*e.g.*, Br. 11-12) that none of the FICA exceptions to the basic definition of "wages" encompasses involuntary severance payments like those at issue here.

Respondents largely disregard the text of FICA and focus instead on 26 U.S.C. 3402(*o*), which is part of a separate chapter of the Internal Revenue Code that addresses income-tax withholding. Respondents

recognize (Br. 45), however, that Congress's enactment of Section 3402(*o*) in 1969 "did not alter the preexisting definition of 'wages'" either in the income-tax-withholding statutes or in FICA. The relevant language in FICA (which has remained substantially the same for more than half a century), interpreted without regard to Section 3402(*o*), unambiguously encompasses involuntary severance payments. And, properly construed in light of its history and placement within the Internal Revenue Code, Section 3402(*o*) provides no basis for declining to apply the FICA definition of "wages" according to its plain terms. The judgment of the court of appeals therefore should be reversed.

### A. Respondents' Severance Payments Are "Wages" Under FICA

As the government's opening brief explains (Br. 10-20), involuntary severance payments constitute "remuneration for employment," and thus fall within FICA's definition of "wages." 26 U.S.C. 3121(a). Respondents do not dispute that such payments are "remuneration," see Br. 34, and the phrase "for employment" naturally encompasses remuneration that functions as a final bonus for an employee's overall body of work. This Court has explained that FICA's definition of "employment" has a "broad reach, extending to 'any service, of whatever nature, performed . . . by an employee for the person employing him,'" *Mayo Found. for Med. Educ. & Research* v. *United States*, 131 S. Ct. 704, 709 (2011) (quoting 26 U.S.C. 3121(b)); that "'service' as used by Congress in this definitive phrase" includes "the entire employer-employee relationship for which compensation is paid to the employee by the employer," *Social Sec. Bd.* v. *Nierotko*,

327 U.S. 358, 365-366 (1946); and that payments made after the employment relationship has ended can qualify as "wages," *Otte* v. *United States*, 419 U.S. 43, 51 (1974); see 26 C.F.R. 31.3121(a)-1(i). The payments at issue here—which were made only to respondents' employees and were calculated by reference to the employees' positions, length of service, and salaries—had a direct and obvious connection to the "employer-employee relationship" and thus qualified as "wages" under FICA's expansive definition.

1. Respondents contend (Br. 35-39) that this Court's decisions interpreting FICA's language broadly should be limited to their facts. The decisions themselves, however, do not support such a limitation. In *Nierotko*, for example, the Court construed the term "'employment'" to include the whole "employer-employee relationship," not because of the particular facts of the case, but because "[t]he very words 'any service . . . performed . . . for his employer,' with the purpose of the Social Security Act in mind, import breadth of coverage." 327 U.S. at 365-366. In adopting that construction, the Court referred with apparent approval to Treasury regulations classifying "dismissal pay" as "wages." *Id.* at 366 n.17.[1]

Respondents assert (Br. 38) that the "proper framework" for analyzing the question presented lies

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[1] The Court noted that the Treasury regulations reached a different conclusion with respect to "voluntary dismissal pay." *Nierotko*, 327 U.S. at 366 n.17. In 1946, however, when *Nierotko* was decided, "[d]ismissal payments which the employer [was] not legally required to make" were specifically excepted from the statutory definition of "wages." 26 U.S.C. 1426(a)(4) (1940); see Gov't Br. 16. That exception was later repealed. See Gov't Br. 16; pp. 4-5, *infra*.

outside this Court's FICA precedents and is instead found in *Coffy* v. *Republic Steel Corp.*, 447 U.S. 191 (1980). Respondents' reliance on *Coffy* is misplaced. That decision does not address the proper interpretation of FICA, but instead concerns the application of the Vietnam Era Veterans' Readjustment Assistance Act of 1974, Pub. L. No. 93-508, 88 Stat. 1578. See, *e.g.*, 447 U.S. at 193. As the government's opening brief explains (at 18-19), the categorical distinction respondents would draw from *Coffy*—between "remuneration for the employee's services or employment" and "payments on account of the elimination of that employment," Resp. Br. 34—does not exist under FICA.

Respondents acknowledge (Br. 41) that payments triggered by the conclusion of an employee's service can fall within FICA's "basic definition of 'wages.'" Were it otherwise, the statute's current and historical exceptions for certain kinds of retirement pay would have been unnecessary. See Gov't Br. 15, 19-20. Respondents offer no basis in FICA for reading the words "remuneration for employment," 26 U.S.C. 3121(a), to include some types of separation pay (like retirement pay) while excluding other types of separation pay (like the severance payments here). Indeed, the Court in *Coffy* recognized that a payment to a laid-off employee is properly considered a "reward for length of service." 447 U.S. at 199. It is therefore a payment that arises out of the "employer-employee relationship," *Nierotko*, 327 U.S. at 366, and it constitutes "wages" under FICA.

2. The history of FICA demonstrates Congress's intent that "dismissal payments" be considered "wages." See Gov't Br. 15-17. From 1939 to 1950, one of

FICA's statutory predecessors, which contained a substantially identical basic definition of "wages," excluded "'[d]ismissal payments which the employer is not legally required to make'" from the scope of that definition. *Id.* at 16 (quoting Social Security Act Amendments of 1939, ch. 666, § 606, 53 Stat. 1383-1384); see note 1, *supra*. That exception indicated that such payments would otherwise have been covered. See, *e.g.*, *American Bank & Trust Co.* v. *Dallas Cnty.*, 463 U.S. 855, 863-864 (1983). When Congress repealed the exception, the accompanying House Report confirmed what was in any event implicit in the repeal itself, namely that any "dismissal payment" would thereafter "constitute wages" unless the recipient had already earned the maximum amount of taxable "wages" for a particular year. H.R. Rep. No. 1300, 81st Cong., 1st Sess. 124 (1949) (1949 House Report); see Pet. App. 24a ("[W]e agree that * * * in the 1950s, all 'dismissal payments' made to employees qualified as FICA 'wages' for purposes of taxation.").

The term "dismissal payment," as used by Congress in that context, referred to "any payment made by an employer on account of involuntary separation of the employee from the service of the employer." 1949 House Report 124. The payments at issue in this case unambiguously satisfy that definition. Respondents nevertheless contend (Br. 29-31) that, because their payments meet the more restrictive definition of "supplemental unemployment compensation benefits" set forth in 26 U.S.C. 3402(*o*)(2)(A), they cannot *also* be "dismissal payments."

Among its other flaws,[2] respondents' cramped interpretation of "dismissal payment" rests on a historical anachronism. In 1950, when Congress amended the statutory definition of "wages" to eliminate the prior exception for discretionary dismissal payments, Section 3402(*o*)(2)(A) did not yet exist. Congress therefore could not have contemplated, when it amended FICA in 1950, that payments meeting a definition in an income-tax-withholding provision enacted 19 years later would be excepted from the rule that "any payment made by an employer on account of involuntary separation of the employee from the service of the employer, will constitute wages." 1949 House Report 124. Nor can Section 3402(*o*) be interpreted as retroactively carving out such an exception, since, *inter alia*, it is undisputed that Section 3402(*o*)'s enact-

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[2] Respondents provide no sound reason why "dismissal payments," as understood by Congress in 1950, and "supplemental unemployment compensation benefits," as defined "for purposes of" Section 3402(*o*), 26 U.S.C. 3402(*o*)(2)(A), should be considered mutually exclusive categories under FICA. In particular, respondents' reliance (Br. 30-31) on certain Treasury regulations is misplaced. First, the regulations they cite address income-tax withholding, not FICA. See 26 C.F.R. 31.3401(a)-1(b)(4) and (14). Second, the cited regulations did not exist until 1957 and 1970 respectively, well after Congress eliminated the prior exception for "[d]ismissal payments which the employer is not legally required to make." See 22 Fed. Reg. 8434 (Oct. 26, 1957); 35 Fed. Reg. 17,328 (Nov. 11, 1970). Finally, the regulations do not dictate that the categories are distinct. One regulation classifies "dismissal payments" as "wages," 26 C.F.R. 31.3401(a)-1(b)(4); the other requires that "[s]upplemental unemployment compensation benefits" be treated as "wages," 26 C.F.R. 31.3401(a)-1(b)(14). No practical difficulties arise if a particular payment is subject to both regulations.

ment "did not alter the preexisting definition of 'wages.'" Resp. Br. 45.

3. Respondents and various amici question the policy wisdom of Internal Revenue Service (IRS) Revenue Ruling 90-72, 1990-2 C.B. 211, and assert that no deference is owed to that administrative document. See Resp. Br. 49-59; ERISA Indus. Comm. Br. 28-33; Am. Benefits Council Br. 2-25; Am. Payroll Ass'n Br. 25-28; see also Hickman Br. 3-35. Those arguments are not germane to the proper disposition of this case. For reasons stated above, and in the government's opening brief, the plain text of FICA dictates that the severance payments at issue here are "wages." Those payments are also "wages" under Revenue Ruling 90-72, even though certain *other* types of payments (namely, payments "linked to the receipt of state unemployment compensation") are not. 1990-2 C.B. at 211; see J.A. 52-53 (joint stipulation that respondents' payments are not linked to state unemployment compensation); Gov't Br. 17-18.

Although respondents and their amici question the propriety of Revenue Ruling 90-72, the government's position in this case would actually be stronger if that Ruling were found to be invalid. The only colorable statutory objection to Revenue Ruling 90-72 is that, by treating severance payments "linked to the receipt of state unemployment compensation" as non-wage payments, 1990-2 C.B. at 211, the Ruling defines the FICA term "wages" in an unduly *narrow* manner. Although the exception defined by Revenue Ruling 90-72 is not grounded in the FICA definition of "wages," Congress appears to have acquiesced in the IRS's longstanding practice of fashioning administrative exceptions of that general character. See Gov't Br. 30.

Any uncertainty about the IRS's authority to take that step, however, would simply reinforce the conclusion that FICA's definition of "wages" cannot be read to exclude an even *broader* class of severance payments, such as the ones at issue here.[3]

### B. Section 3402(*o*) Does Not Implicitly Constrict FICA's Definition Of "Wages"

Respondents make no meaningful effort to dispute that FICA's definition of "wages," taken on its own terms, encompasses the severance payments at issue in this case. Rather, respondents ask this Court to draw a negative inference from Section 3402(*o*), which governs income-tax withholding and directs that any "supplemental unemployment compensation benefit" as defined in that provision "shall be treated as if it were a payment of wages by an employer to an employee for a payroll period." 26 U.S.C. 3402(*o*)(1). Respondents argue that, because the statutory definition of "supplemental unemployment compensation benefits" (26 U.S.C. 3402(*o*)(2)(A)) encompasses the severance payments at issue in this case, and because Section 3402(*o*) mandates that such payments "shall

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[3] Contrary to respondents' suggestion (Br. 31), the Court's resolution of the question presented here will have no effect on the "statutory framework for unemployment benefits set up between the federal government and state governments." Federal law encourages States to give extended unemployment benefits to recipients of "supplemental unemployment compensation benefits," as defined in 26 U.S.C. 501(c)(17)(D). See 26 U.S.C. 3304(a)(11); Federal-State Extended Unemployment Compensation Act of 1970, Pub. L. No. 91-373, 84 Stat. 708, as amended by the Omnibus Reconciliation Act of 1980, Pub. L. No. 96-499, 94 Stat. 2659. The operation of that federal-state program does not depend on whether the "supplemental unemployment compensation benefits" are considered "wages" under FICA. See *ibid.*

be treated" for withholding purposes "as if" they were "payment[s] of wages," such payments cannot actually *be* "wages" under *any* Internal Revenue Code provision. That analysis is misconceived.

1. Respondents do not explain why FICA's application to particular types of severance payments should be controlled by negative inferences drawn from Section 3402(*o*), a substantive income-tax-withholding provision whose scope is limited to Chapter 24 (the income-tax-withholding chapter) and certain related procedural provisions of the Internal Revenue Code. See Gov't Br. 22-25. As our opening brief explains (at 25-26), and contrary to respondents' assertions (Br. 42-44), nothing in *Rowan Cos.* v. *United States*, 452 U.S. 247 (1981), requires that a court look to the substantive rules for income-tax withholding in order to determine what sorts of payments are "wages" under FICA. Rather, "Congress's decision to restrict the scope of the rule set forth in [S]ection 3402(*o*) to chapter 24 suggests that Congress did not intend that rule, or any implication that might be drawn from that rule, to be applied outside the context of income tax withholding." *CSX Corp.* v. *United States*, 518 F.3d 1328, 1341 (Fed. Cir. 2008).

The result in *Rowan* was premised on Congress's intent that the "methods of collection, payment, and administration of the withholding tax" be "coordinated generally with those applicable to the Social Security tax" now imposed by FICA. 452 U.S. at 256 (quoting S. Rep. No. 221, 78th Cong., 1st Sess. 17 (1943)); see *Environmental Def.* v. *Duke Energy Corp.*, 549 U.S. 561, 575 (2007) (recognizing that the holding in *Rowan* turned on Congress's "interest [in] simplicity and ease of administration") (quoting *Rowan*, 452 U.S. at 257).

Respondents' invocation of *Rowan* is especially misplaced because the inference they would draw from Section 3402(*o*) would produce greater *dis*uniformity between the rules governing income-tax withholding and those governing FICA taxation. Respondents interpret Section 3402(*o*), which directs that certain payments be "treated as * * * wages" for purposes of collection, payment, and administration of income-tax withholding, to mean that *none* of those same payments should be treated as "wages" for purposes of collection, payment, and administration of FICA tax. That approach flies in the face of *Rowan*.

2. Respondents also identify no sound reason to conclude that the severance payments at issue in this case are not "wages" for purposes of income-tax withholding. Respondents' affirmative argument on this issue (Br. 17-39) relies on this Court's decision in *Coffy* and on Section 3402(*o*). For reasons explained above and in our opening brief, respondents' reliance on *Coffy* is misplaced. And respondents' reliance on Section 3402(*o*) is undermined by their acknowledgment (Br. 45) that Section 3402(*o*)'s enactment "did not alter the preexisting definition of 'wages.'" If Section 3402(*o*) "did not alter the preexisting definition of 'wages,'" then the critical question is what the "preexisting definition of 'wages'" was *before* Section 3402(*o*) was enacted.

In any event, Section 3402(*o*) does not, as respondents contend, imply that *all* payments encompassed by Section 3402(*o*)(2)(A)'s definition of "supplemental unemployment compensation benefits" are excluded from the basic definition of "wages." See Gov't Br. 27-28. An instruction that every pickup truck "be treated as if it were a commercial vehicle" would not imply

that pickup trucks can never be commercial vehicles; an instruction that every man "be treated as if he were six feet tall" would not imply that men can never be six feet tall; and an instruction that every guest "be treated as if he were a member of the family" would not imply that guests can never be family members. The title of Section 3402(*o*)—"[e]xtension of withholding to *certain* payments other than wages" (emphasis added)—likewise does not preclude the possibility that at least *some* of the covered payments are already "wages." See Gov't Br. 28 n.3.

Respondents rely (Br. 22-23) on Section 3402(*o*)(1)(C), which authorizes (but does not require) income-tax withholding from "sick pay which does not constitute wages." The limiting language "which does not constitute wages" reflects Congress's evident understanding that some sick pay would constitute "wages." Respondents are wrong, however, in arguing that the absence of similar language in Section 3402(*o*)(2)(A) suggests a different congressional understanding with respect to "supplemental unemployment compensation benefits."

Section 3402(*o*)(1)(C) was added to the statute in 1980, see Act of Dec. 24, 1980, Pub. L. No. 96-601, § 4(a), 94 Stat. 3496, 11 years after Section 3402(*o*)'s enactment, and it therefore provides little evidence of Congress's intent in enacting the original provision. In any event, Section 3402(*o*)(1)(C)'s special withholding rule applies only if the employee has made a specific "request that such sick pay be subject to withholding." If Congress had failed to clarify that the voluntary withholding rule in Section 3402(*o*)(1)(C) applies only to sick pay "which does not constitute wages," the rule might have been interpreted to re-

quire a "request" as a prerequisite to withholding even from sick pay that is *already* considered to be "wages." Because Section 3402(*o*)(1)(A) contains no similar "request" requirement, no similar clarifying language was necessary, as no practical harm results from applying Section 3402(*o*)(1)(A)'s automatic-withholding rule to payments that are already "wages."

Respondents' reliance (Br. 21) on *National Federation of Independent Business* v. *Sebelius*, 132 S. Ct. 2566 (2012), is also misplaced. In that case, the Court rejected the contention that a particular "assessable penalty" was a "tax" under the Internal Revenue Code. *Id.* at 2584. The Court noted the existence of "many provisions treating taxes and assessable penalties as distinct terms," and it recognized that "[t]here would, for example, be no need for [26 U.S.C.] 6671(a) to deem 'tax' to refer to certain assessable penalties if the Code already included *all such* penalties in the term 'tax.'" *Ibid.* (emphasis added). This case, in contrast, does not involve a multitude of provisions drawing a "consistent distinction," *ibid.*, between "wages" and "supplemental unemployment compensation benefits." Nor has the government taken the position that Congress believed "all such" benefits, *ibid.*, were necessarily "wages." Rather, the government's position is simply that Section 3402(*o*) allows for the possibility that *some* such benefits *could* be "wages." See Gov't Br. 28.

As the government's opening brief explains (Br. 28-35), Congress intended Section 3402(*o*) as a catch-all provision to ensure that whatever *subset* of "supplemental unemployment compensation benefits" the IRS deemed in its Revenue Rulings to be non-"wages"

would be subject to income-tax withholding. Respondents agree (Br. 58) that Congress "presumably was aware of the IRS' revenue rulings" when it enacted Section 3402(*o*). Respondents correctly observe (*e.g.*, *ibid.*) that Section 3402(*o*)(2)(A) defined the set of payments subject to "treat[ment] as * * * wages," 26 U.S.C. 3402(*o*)(1), more broadly than the set of payments considered to be non-"wages" under the then-existing Revenue Rulings. But in light of Congress's undisputed intent to leave the pre-existing definition of "wages" intact, Resp. Br. 45, that additional breadth cannot be taken as a sign that Congress sought to require additional types of payments, beyond those addressed in the Revenue Rulings, to be classified as non-"wages." Rather, the additional breadth accommodated the possibility that the IRS might issue further Rulings classifying additional types of payments as non-"wages." See Gov't Br. 33-35. There was no downside to accommodating that possibility, because requiring a payment already considered "wages" to be "treated as if it were a payment of wages" would not create any practical difficulties.[4]

3. Respondents' primary argument appears to be that the 1969 Congress *believed* that no "supplemental unemployment compensation benefits" (as defined in

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[4] Like respondents, amicus ERISA Industry Committee acknowledges that Congress legislated against the backdrop of the IRS Revenue Rulings. Br. 17-20. It contends, however, that when Congress recodified Section 3402(*o*) in 1986, it intended to require the IRS to adhere in perpetuity to the then-current Revenue Ruling on this topic, which was promulgated in 1977. See *ibid.* The amicus does not explain, however, why Section 3402(*o*)'s original 1969 enactment would allow the IRS the flexibility to issue modified guidance in 1977, but the reenactment of that same language would preclude any further modifications.

that provision) could constitute "wages" for any Internal Revenue Code purpose, and that the FICA definition of "wages" should be construed to render it consistent with that belief. That analysis is misconceived.

Because individual statutory provisions are properly construed in light of the larger statutory context, a later-enacted provision may sometimes assist in choosing between textually-plausible readings of an earlier-enacted one. See, *e.g.*, *Bilski* v. *Kappos*, 130 S. Ct. 3218, 3228-3229 (2010); *United States* v. *Fausto*, 484 U.S. 439, 453 (1988). That principle is inapplicable here, however, because the FICA definition of "wages" in effect in 1969—which then, as now, covered all "remuneration for employment," 26 U.S.C. 3121(a) (1964)—*unambiguously* encompassed the severance payments at issue in this case. To treat Section 3402(*o*) as excluding all "supplemental unemployment compensation benefits" from the FICA definition of wages would be to recognize a form of repeal by implication, a mode of statutory analysis that is severely disfavored. See *Fausto*, 484 U.S. at 452-453.

The 1969 Congress would have had no plausible ground for believing that "supplemental unemployment compensation benefits" as defined in Section 3402(*o*)(2)(A) were categorically outside FICA's definition of "wages." In 1946, this Court had explained that the definition of "employment" encompasses the "the entire employer-employee relationship." *Nierotko*, 327 U.S. at 365-366. In 1950, Congress had repealed the prior exception for discretionary dismissal payments to effectuate its intent that "any payment made by an employer on account of involuntary separation of the employee from the service of the employ-

er, will constitute wages" under FICA. 1949 House Report 124. In 1957, the IRS had promulgated a regulation—still in effect in 1969 (and today)—specifying that "[a]ny payments made by an employer to an employee on account of dismissal, that is, involuntary separation from the service of the employer, constitute wages" for income-tax-withholding purposes. 22 Fed. Reg. 8434 (Oct. 26, 1957); see 26 C.F.R. 31.3401(a)-1(b)(4) (1969); see also 26 C.F.R. 31.3401(a)-1(b)(4). And while the IRS Revenue Rulings had identified *some* types of "supplemental unemployment compensation benefits," as later defined in Section 3402(*o*)(2)(A), as non-"wages," the IRS had historically considered other types (like the ones at issue here) to be "wages." Gov't Br. 29-31, 33; see Resp. Br. 58; Pet. App. 25a n.5.

The only contemporaneous source of law[5] that respondents cite (Br. 28) as supporting the narrow view

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[5] In support of its argument that payments covered by Section 3402(*o*) are non-"wages," amicus American Payroll Association cites (Br. 19-25) various IRS materials that post-date Section 3402(*o*)'s enactment. Those materials do not illuminate the state of the law in 1969. In any event, the amicus is wrong in suggesting that the IRS has, since 1969, consistently treated payments like respondents' as non-"wages." In 1971, the IRS issued Revenue Ruling 71-408, 1971-2 C.B. 340, which concluded that payments very similar to respondents' payments here—"dismissal payments to * * * eligible employees" following an employer's "discontinuance of operations"—were "wages" for FICA and income-tax-withholding purposes. *Id.* at 341. Internal IRS records reflecting the receipt of thousands of refund claims following *CSX Corp.* v. *United States*, 52 Fed. Cl. 208 (2002), rev'd, 518 F.3d 1328 (Fed. Cir. 2008), the first decision ever to hold that such payments are *not* "wages," provide strong evidence that employers and employees have been paying FICA taxes on those payments. Sources cited by the amicus (Br. 19-25)—a 1977 Revenue Ruling, which was

of "wages" they attribute to the 1969 Congress is a pair of regulations that did not purport to interpret either FICA or the income-tax-withholding statutes. See 26 C.F.R. 1.501(c)(17)-2(j), 1.6041-2(b)(1) (1968). Those regulations address the reporting requirements for a trust enjoying tax-exempt status due to its payment of "supplemental unemployment compensation benefits" as defined in 26 U.S.C. 501(c)(17)(D), a provision that is part of neither FICA nor the income-tax-withholding statutes and that says nothing about "wages." The regulations require such a trust to report certain payments on IRS Form 1099, rather than on the Form W-2 typically used to report payments of "wages." Respondents assert (Br. 28) that the regulations "implicitly" reflect the Treasury Department's view that all "supplemental unemployment compensation benefits" were "not wages."

If the Treasury Department had held that view, however, it would not have continued to promulgate a separate regulation instructing that "[*a*]*ny* payments made by an employer to an employee on account of dismissal, that is, involuntary separation from the service of the employer, constitute wages" for withholding purposes. 26 C.F.R. 31.3401(a)-1(b)(4) (1968) (emphasis added). The regulations cited by respondents are, at most, evidence of the IRS's assumption

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retracted in 1990, see Gov't Br. 34 n.5; a Second Circuit brief filed in 1988, which urged that certain payments *were* "wages," see Gov't Cert. Reply Br. 5 n.1; and imprecise instructions on tax forms intended for laypersons, which are not authoritative sources of law, see, *e.g.*, *Casa de La Jolla Park, Inc.* v. *Commissioner*, 94 T.C. 384, 396 (1990); *Green* v. *Commissioner*, 59 T.C. 456, 458 (1972); *Adler* v. *Commissioner*, 330 F.2d 91, 93 (9th Cir. 1964)—do not support the amicus's contention that the IRS has a longstanding legal position in conflict with that widespread practice.

that all tax-exempt trusts paying "supplemental unemployment compensation benefits" were structured in a manner that would allow their payments to be considered non-"wages" under the then-existing Revenue Rulings. At the time, it was "standard procedure" for employers and employees negotiating a supplemental unemployment benefit plan to design the plan in a way that would avoid the payments being classified as "wages." Joseph M. Becker, *Guaranteed Income for the Unemployed: The Story of SUB* 60 (1968); see *id.* at 61 (observing that the IRS "has had a significant influence on the development of" supplemental unemployment benefits). In any event, regulations addressing payments from trusts provide no support for the non-wage status of payments, like those at issue in this case, that are made directly by an employer without the use of a trust.[6]

4. In arguing that the pre-1969 definition of "wages" excluded payments like theirs, respondents rely heavily (Br. 24-29) on statements in the legislative

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[6] Amicus American Payroll Association asserts (Br. 18 n.9), without citation, that the 1968 regulations were directed at trusts because trusts were "invariably" used to make these sorts of benefits payments "at the time." But as far back as 1960, employers had expressed interest in compensating laid-off employees without the use of a trust. See Rev. Rul. 60-330, 1960-2 C.B. 46 (responding to a request for "[a]dvice" on that subject). Indeed, the amicus goes on to acknowledge (Br. 18 n.9) that such compensation could have been paid "directly by employers." See also Br. 17 n.7. The amicus's unsupported assertion (Br. 18 n.9) that an employer paying such compensation would not have reported it as "wages" on a Form W-2 is implausible. The amicus provides no reason to believe that employers systematically violated 26 C.F.R. 31.3401(a)-1(b)(4) (1968), which classified all "involuntary separation" payments as "wages."

record accompanying Section 3402(*o*). As the government's opening brief explains (Br. 25, 35-36), those statements do not advance respondents' argument. Views expressed in the legislative history of a 1969 statute are not an authoritative source on the meaning of statutes enacted many years earlier. See, *e.g.*, *United States* v. *Woods*, No. 12-562 (Dec. 3, 2013), slip op. 16 (reiterating that "post-enactment legislative history (a contradiction in terms) is not a legitimate tool of statutory interpretation") (quoting *Bruesewitz* v. *Wyeth LLC*, 131 S. Ct. 1068, 1081 (2011)) (brackets omitted).

In any event, the legislative-record references on which respondents rely are best read as descriptions of the non-wage status of certain types of "supplemental unemployment benefits" under the then-existing IRS Revenue Rulings. Gov't Br. 35-36; see, *e.g.*, Rev. Rul. 56-249, 1956-1 C.B. 488, 490 (identifying certain payments as "supplemental unemployment benefits" and describing them as non-"wages"); Rev. Rul. 58-128, 1958-1 C.B. 89, 89-90 (same); Rev. Rul. 60-330, 1960-2 C.B. 46, 46-48 (same).[7] Although re-

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[7] Respondents contend (Br. 27) that the Revenue Rulings' discussion of the non-wage status of certain payments would not explain the Senate committee report's statement that "supplemental unemployment benefits * * * do not constitute wages *or* remuneration for services." S. Rep. No. 552, 91st Cong., 1st Sess. 268 (1969) (emphasis added). But since "wages" were (and still are) defined as "remuneration for * * * services," 26 U.S.C. 3401(a) (1964)—or as "remuneration for employment," 26 U.S.C. 3121(a) (1964)), with "employment" defined, in turn, to include "any service, of whatever nature," 26 U.S.C. 3121(b) (1964)—the reference to "remuneration for services" is simply another way of referring to "wages." See *Woods*, slip op. 14 ("'or' * * * can sometimes introduce an appositive").

spondents dispute that interpretation, they identify nothing else to which the statements could plausibly have referred. For all the reasons discussed above (see pp. 13-17, *supra*), the law in 1969 provided no support for a belief that the pre-1969 definition of "wages" excluded *all* of the payments later described in Section 3402(*o*)(2)(A).

Although the IRS's pre-1969 Revenue Rulings provide the best explanation for why Congress perceived a need to enact Section 3402(*o*), this Court need not accept that explanation (or the validity of the Rulings themselves) to decide this case in the government's favor. Respondents could not prevail here even if the 1969 Congress could be shown to have believed that the pre-existing statutory definition of "wages" excluded all "supplemental unemployment compensation benefits" as later defined in Section 3402(*o*)(2)(A). Such a belief would have been contrary to the plain text of FICA's definition of "wages." Even assuming, *arguendo*, that the 1969 Congress failed to appreciate the breadth of that definition, Congress's enactment of Section 3402(*o*) would not have transformed that incorrect belief into reality.

In enacting Section 3402(*o*), Congress addressed a problem (large end-of-year tax bills) that arose from the IRS's view that certain types of severance payments were taxable income to the recipient but were not "wages" subject to withholding. Gov't Br. 32-33; Resp. Br. 25-26. There is no reason to suppose that Congress intended its solution to expand the set of payments as to which the problem would arise. Rather, Congress left intact the broad pre-existing definition of "wages," the plain language of which unambiguously encompasses the payments at issue here.

* * * * *

For the foregoing reasons and those stated in the government's opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

DONALD B. VERRILLI, JR.
*Solicitor General*

DECEMBER 2013

# AMICUS CURIAE BRIEF

No. 12-1408

Supreme Court, U.S.
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DEC 13 2013
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IN THE

# Supreme Court of the United States

UNITED STATES,

*Petitioner,*

*v.*

QUALITY STORES, INC., *et al.*,

*Respondents.*

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

## BRIEF OF *AMICUS CURIAE* THE AMERICAN BENEFITS COUNCIL IN SUPPORT OF RESPONDENTS

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## TABLE OF CONTENTS

***Page***

I. INTEREST OF *AMICUS CURIAE* ..... 1

II. SUMMARY OF ARGUMENT ..... 2

III. ARGUMENT ..... 5

A. Framework for analysis ..... 6

B. Application of *Skidmore* standard ..... 11

C. Other flaws in government position ..... 17

IV. CONCLUSION ..... 25

## TABLE OF AUTHORITIES

***Page(s)***

**Cases**

*Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984) ..... 6, 7, 8, 9, 10, 11, 19

*City of Arlington v. FCC*, 133 S. Ct. 1863 (2013) ..... 10

*CSX Corp. v. United States*, 518 F.3d 1328 (Fed. Cir. 2008) ..... 3

*Mayo Foundation for Medical Education and Research v. United States*, 131 S. Ct. 704 (2011) ..... 6, 7

*Skidmore v. Swift & Co.*, 323 U.S. 134 (1944) ..... 8, 10, 11, 13, 14, 19

*United States v. Mead Corporation*, 533 U.S. 218 (2001) ..... 7, 8, 9, 10, 19

*United States v. Quality Stores, Inc.*, 693 F.3d 605 (6th Cir. 2012) ..... 18, 20

**Statutes**

5 U.S.C. § 706(2)(A) ..... 23

26 U.S.C. § 3402(o) ..... 1, 11, 13, 23

26 U.S.C. § 3402(o)(2)(A) ..... 2, 3

**Regulations**

26 C.F.R. § 601.601(d)(2)(i)(a) ..... 9

26 C.F.R. § 601.601(d)(2)(v)(a) ..... 9

26 C.F.R. § 601.601(d)(2)(v)(d) ..... 9

26 C.F.R. § 601.601(d)(2)(v)(e) ..... 9

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Brief for the Appellant, *United States v. Quality Stores, Inc.*, 693 F.3d 605 (6th Cir. 2012) (No. 10-1563) ..... 18, 20, 21, 22

Petition for Rehearing *En Banc*, *United States v. Quality Stores, Inc.*, 693 F.3d 605 (6th Cir. 2012) (No. 10-1563) ..... 18

Reply Brief for the Appellant, *United States v. Quality Stores, Inc.*, 693 F.3d 605 (6th Cir. 2012) (No. 10-1563) ..... 18, 22

Rev. Rul. 56-249,
1956-1 CB 488 ..... 11, 12, 13, 14, 16, 20

Rev. Rul. 59-227,
1959-2 C.B. 13 ..... 13

Rev. Rul. 77-347,
1977-2 C.B. 362 ..... 11, 12, 13

Rev. Rul. 90-72,
1990-2 C.B. 211 ..... *passim*

Patrick J. Smith, Chevron *Step Zero After* City of Arlington,
140 Tax Notes 713 (2013) ..... 10

Patrick J. Smith, Quality Stores *and the Status of Revenue Rulings*,
140 Tax Notes 1089 (2013) ..... 5

## I. INTEREST OF *AMICUS CURIAE*

The American Benefits Council (ABC) is a broad-based nonprofit organization dedicated to protecting and fostering privately sponsored employee benefit plans under ERISA.[1] ABC's more than 360 members include large employer sponsors of employee benefit plans, as well as organizations that provide services to employers of all sizes regarding their employee benefit programs. Collectively, ABC's members either directly sponsor or provide services to ERISA plans covering more than 100 million Americans. ABC regularly participates as amicus curiae in this Court and in other courts on issues that affect employee benefit plan design or administration.

ABC and its members have a substantial interest in this case, which presents the issue of how to determine which supplemental unemployment compensation benefits are excluded from taxable wages for purposes of the Federal Insurance Contributions Act. ABC submits that the Sixth Circuit provided the proper answer to this question by using the statutory definition in 26 U.S.C. § 3402(o).

[1] No party or counsel for a party authored this brief in whole or in part. No party, counsel for a party, or person other than *amicus curiae*, its members, or its counsel made a monetary contribution intended to fund the preparation or submission of the brief. Both parties have consented to the filing of this brief.

## II. SUMMARY OF ARGUMENT

The government and Quality Stores agree that some supplemental unemployment compensation benefits are excluded from taxable wages for purposes of the Federal Insurance Contribution Act, even though such benefits are included in the recipient's taxable income and are subject to income tax withholding. The parties disagree, however, on which such benefits are excluded from taxable wages for FICA purposes.

The government contends the supplemental unemployment compensation benefits that are excluded from taxable wages for FICA purposes are only those benefits that satisfy the requirements imposed by a series of revenue rulings issued by the IRS starting in 1956 and continuing through 1990. Quality Stores contends the benefits excluded from taxable wages for FICA purposes are any benefits that come within the statutory definition of supplemental unemployment compensation benefits in section 3402(o)(2)(A) that applies for income tax withholding purposes.

The benefits at issue in this case are severance payments that were made to employees in connection with the termination of the taxpayer's business operations. These benefit payments do not satisfy the requirements imposed by the IRS revenue rulings because the benefits were not in any way tied to state unemployment compensation benefits, whereas the most recent revenue ruling requires such coordination in order for benefits to be excluded from taxable wages for FICA purposes. In contrast, however, the benefits at issue in this case come

within the statutory definition of supplemental unemployment compensation benefits in section 3402(o)(2)(A). Unlike the most recent revenue ruling, this statutory definition does not contain any requirement that the benefits must be tied to state unemployment compensation benefits.

The Sixth Circuit agreed with Quality Stores that the statutory definition controls, even though the definition by its terms applies only for income tax withholding purposes and not for FICA purposes. However, in an earlier case involving a different taxpayer that presented the same issue, *CSX Corp. v. United States*, 518 F.3d 1328 (Fed. Cir. 2008), the Federal Circuit agreed with the government that the revenue rulings, rather than the statutory definition, are controlling for FICA purposes.

Most of the emphasis in the briefs and the opinions in both the Sixth Circuit and the Federal Circuit focused on whether the taxpayer in each case was correct that the definition of supplemental unemployment compensation benefits in section 3402(o)(2)(A) that is applicable for income tax withholding purposes determines which benefits are excluded from taxable wages for FICA purposes, and not on whether the government is correct that only benefits that satisfy the requirements of the revenue rulings are excluded from taxable wages for FICA purposes. However, an evaluation of the merits of the taxpayer's position is only part of the picture, and should not be the sole basis for deciding the case.

The resolution of the case must also take into account an evaluation of the merits of the government's position. In that regard, the government is mistaken in its position that a series

of IRS revenue rulings can properly establish a controlling answer to the legal issue of which supplemental unemployment compensation benefits are excluded from taxable wages for FICA purposes.

It is notable that the government itself is equivocal in its position regarding the legal status of these revenue rulings. While the government contends the IRS revenue rulings determine what benefits are excluded from taxable FICA wages, the government does not provide an explanation for why the positions taken in these revenue rulings should be controlling in determining which benefits are excluded from taxable FICA wages. Moreover, the government does not even contend that the positions taken in these rulings are correct, much less provide an explanation for why the IRS believes these positions are correct.

The government simply contends that because the benefits at issue in the case do not meet the requirements in the rulings, these benefits cannot be excluded from FICA wages. The government asserts that it is not claiming the revenue rulings are entitled to judicial deference, while failing to explain how it might be that IRS documents such as revenue rulings that the government acknowledges are not entitled to deference could nevertheless be determinative on the issue of which supplemental unemployment compensation benefits are excluded from taxable wages for FICA purposes.

When the issue in the case is evaluated not merely from the perspective of the merits of the taxpayer's position on which supplemental unemployment compensation benefits are excluded from taxable wages for FICA purposes, but also from

the perspective of the merits of the government's position that relies on the revenue rulings, there can be no doubt that the taxpayer's position is preferable, since the taxpayer's position provides a coherent and sensible answer to the issue, whereas the government does not offer an alternative to the taxpayer's position that is coherent or supportable.[2]

## III. ARGUMENT

The fundamental problem with the government's position as to which supplemental unemployment compensation benefits are excluded from taxable wages for FICA purposes is that the government offers no real alternative to the taxpayer's position on this issue. Instead, the government offers a completely unsatisfactory combination of partial positions that do not come together into a coherent whole.

The government contends that the particular benefits that are at issue in this case do not come within the category of supplemental unemployment compensation benefits that are excluded from taxable wages for FICA purposes because these benefits do not come within the terms of a series of revenue rulings the IRS has issued on this subject. However, the government has made no effort to defend the conclusions reached in these revenue rulings and contends instead that the correctness of

[2] The arguments presented in this brief are derived from an article written by counsel of record for *amicus*. *See* Patrick J. Smith, Quality Stores *and the Status of Revenue Rulings*, 140 Tax Notes 1089 (2013).

the conclusions in these revenue rulings is not at issue in the case.

Nevertheless, the government repeatedly asserts that the reason the benefits at issue in this case cannot be excluded from taxable wages for FICA purposes is because the benefits do not satisfy the requirements of the revenue rulings. In order to evaluate the government's position that these revenue rulings are controlling on this issue, it is necessary to review the principles that apply in determining the legal status of agency documents such as IRS revenue rulings.

### A. Framework for analysis

The framework for determining the status of agency guidance documents such as IRS revenue rulings was clarified by *Mayo Foundation for Medical Education and Research v. United States*, 131 S. Ct. 704 (2011). *Mayo* did not deal directly with IRS guidance documents such as revenue rulings. The specific issue in *Mayo* instead concerned the standards to be used in evaluating the validity of IRS regulations. In that regard, *Mayo* clarified that the validity of IRS regulations must be evaluated under the same standard that applies for all other agencies, namely, the two-part test set forth in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). Under that test, a regulation will be upheld (1) if, using traditional tools of statutory construction, a court determines that Congress did not address the question at issue, and (2) if the position adopted by the regulation is reasonable. *Id.* at 842-43, 843 n.9.

However, in reaching the conclusion that IRS regulations are evaluated under the *Chevron* test, *Mayo* also made clear that, more generally, judicial review of IRS action is subject to the same rules and principles that apply in the case of judicial review of action by any other federal agency: "[W]e are not inclined to carve out an approach to administrative review good for tax law only. To the contrary, we have expressly '[r]ecogniz[ed] the importance of maintaining a uniform approach to judicial review of administrative action.'" 131 S. Ct. at 713.

With respect to the application of the "uniform approach to judicial review of administrative action" referred to in this passage from *Mayo* in the case of agency guidance documents that are not evaluated under the *Chevron* two-part test, significant clarification of the *Chevron* framework had previously been provided in *United States v. Mead Corporation*, 533 U.S. 218 (2001). *Mayo*'s reference to "the importance of maintaining a uniform approach to judicial review of administrative action" leaves no doubt that *Mead*'s clarification of the *Chevron* framework is fully applicable in tax cases. *Mead* clarified not only how to determine which agency guidance documents are evaluated under the *Chevron* two-part test but also what weight a court should give to agency guidance documents that do not satisfy the standards for being evaluated under the *Chevron* two-part test.

*Chevron* itself did not make clear whether all agency guidance documents are evaluated under the *Chevron* two-part test and are thus potentially eligible for judicial deference under that test. *Mead* clarified that not all agency guidance documents are

eligible for deference under *Chevron*. *Mead* clarified that the agency guidance documents that are eligible to be evaluated under the *Chevron* two-part test, and therefore eligible to receive judicial deference, are only those where "Congress delegated authority to the agency generally to make rules carrying the force of law, and ... the agency interpretation claiming deference was promulgated in the exercise of that authority." *Id.* at 226-27.

Thus, the only agency guidance documents that are eligible for *Chevron* deference are guidance documents the agency intended to have "the force of law." As a result, generally only relatively formal agency guidance documents, such as regulations, are eligible for *Chevron* deference. The agency's use of notice-and-comment procedures to issue guidance usually shows the agency intended the guidance to have the force of law, and guidance issued under those procedures will ordinarily receive *Chevron* deference. *Id.* at 230.

*Mead* also clarified that agency guidance documents that are not eligible for *Chevron* deference, because, for example, the agency did not intend the documents to have the force of law, are not as a consequence automatically given no weight by a reviewing court. Instead, such agency guidance documents are given the weight determined under the standard articulated in *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944). Under that standard, agency guidance receives weight based on the document's "power to persuade," which "will depend on the thoroughness evident in its consideration; the validity of its reasoning; its consistency with earlier and later pronouncements; and all those factors

which give it power to persuade, if lacking power to control." *Id.* at 140.

When the *Mead* test for determining which agency guidance documents are eligible for deference under the *Chevron* test is applied to IRS revenue rulings, it is clear that such rulings are not eligible for *Chevron* deference. Revenue rulings are not issued using notice-and-comment procedures, and the IRS does not claim that revenue rulings have the force of law that IRS regulations have. Instead, IRS revenue rulings represent the IRS's application of the law to particular factual situations. *See, e.g.*, 26 C.F.R. § 601.601(d)(2)(v)(d) ("Revenue rulings published in the Bulletin do not have the force and effect of Treasury Department Regulations (including Treasury decisions), but are published to provide precedents to be used in the disposition of other cases, and may be cited and relied upon for that purpose"); 26 C.F.R. § 601.601(d)(2)(i)(a) ("A Revenue Ruling is an official interpretation by the Service that has been published in the Internal Revenue Bulletin. Revenue Rulings are issued only by the National Office and are published for the information and guidance of taxpayers, Internal Revenue Service officials, and others concerned"); 26 C.F.R. § 601.601(d)(2)(v)(a) ("The conclusions expressed in Revenue Rulings will be directly responsive to and limited in scope by the pivotal facts stated in the revenue ruling"); 26 C.F.R. § 601.601(d)(2)(v)(e) ("[S]ince each Revenue Ruling represents the conclusion of the Service as to the application of the law to the entire state of facts involved, taxpayers, Service personnel, and others concerned are cautioned against reaching the same

conclusion in other cases unless the facts and circumstances are substantially the same").

Moreover, while *Mead* suggested that agency interpretations that were not issued using notice-and-comment rulemaking procedures might under some circumstances be eligible to be evaluated using the *Chevron* two-part test, *see, e.g.*, 533 U.S. at 227 ("As significant as notice-and-comment is in pointing to *Chevron* authority, the want of that procedure here does not decide the case, for we have sometimes found reasons for *Chevron* deference even when no such administrative formality was required and none was afforded."), that position seems to have been abandoned in *City of Arlington v. FCC*, 133 S. Ct. 1863 (2013). *See, e.g., id.* at 1874 ("*Mead* denied *Chevron* deference to action, by an agency with rulemaking authority, that was not rulemaking."; "It suffices to decide this case that the preconditions to deference under *Chevron* are satisfied because Congress has unambiguously vested the FCC with general authority to administer the Communications Act through rulemaking and adjudication, and the agency interpretation at issue was promulgated in the exercise of that authority.") For a more extended discussion of this point, see Patrick J. Smith, Chevron *Step Zero After* City of Arlington, 140 Tax Notes 713 (2013). In any event, in litigating this case, the government has explicitly disavowed any claim that the revenue rulings that are relevant to the case should be evaluated under *Chevron*.

Thus, it is clear that the IRS revenue rulings dealing with supplemental unemployment compensation benefits are evaluated under the *Skidmore* "power to persuade" standard and not

under *Chevron*'s two-part test. While agency guidance documents that are evaluated under *Chevron*'s two-part test can establish law, provided they satisfy both parts of the test, agency guidance documents that are evaluated under the *Skidmore* standard cannot establish law. For agency guidance documents that are evaluated under *Skidmore*, even in cases where the reviewing court adopts the position expressed in the guidance document by the agency, the reviewing court's reason for adopting the agency position is not because that position establishes the law but only because the reviewing court finds the agency position persuasive.

### B. Application of *Skidmore* standard

Under *Skidmore*, the revenue rulings on which the government relies in this case would be given little if any weight because of their lack of reasoning and the inconsistency among the positions expressed in these revenue rulings.

The most obvious inconsistency among the revenue rulings relates to the issue of whether the benefits must be tied to state unemployment compensation benefits in order for the benefits to be excluded from taxable wages for FICA purposes. On this issue, the IRS has reversed its position not just once but twice.

In Rev. Rul. 56-249, 1956-1 CB 488, the benefits that were held to be excluded from taxable FICA wages were tied to the amount of state unemployment compensation benefits. However, in Rev. Rul. 77-347, 1977-2 C.B. 362, the IRS relied on the enactment of section 3402(o) to conclude that

"the fact that benefits under the plan are not tied to the State's unemployment benefits is not a material or controlling factor." Thus, in Rev. Rul. 77-347, the IRS reversed the position it had taken in Rev. Rul. 56-249 that benefits must be tied to state unemployment compensation benefits in order to be excluded from taxable wages for FICA purposes. The government's petition for certiorari completely ignores Rev. Rul. 77-347 and thus neither acknowledges nor attempts to explain this reversal of position. The government's brief in this Court acknowledges the reversal of position in Rev. Rul. 77-347, but only in a footnote and without any attempt to explain the reversal. *See* Brief for the Petitioner at 34 n.5. This brief simply notes that "the scope of the IRS's administrative exception has changed over time." *Id.* at 34.

The IRS reversed its position on this issue for a second time in Rev. Rul. 90-72, 1990-2 C.B. 211, concluding that Rev. Rul. 77-347 was incorrect on this issue:

> The portion of Rev. Rul. 77-347 concluding that benefits do not have to be linked to state unemployment compensation in order to be excluded from the definition of wages for FICA and FUTA tax purposes is inconsistent with the underlying premises for the exclusion and is therefore hereby revoked. This action restores the distinction between SUB pay and dismissal pay by re-establishing the link between SUB pay and state unemployment compensation set forth in Rev. Rul. 56-249.

*Id.* at 212.

Rev. Rul. 90-72 based this conclusion on the conclusion that Rev. Rul. 77-347 was incorrect in relying on section 3402(o). "[S]ection 3402(o) is not applicable for FICA or FUTA purposes." *Id.* Since the government's petition for certiorari ignores Rev. Rul. 77-347, the petition likewise fails to acknowledge this second reversal of position by the IRS on this issue. The government's brief in this Court acknowledges the second reversal of position, but only in the same footnote that acknowledges the first reversal of position in Rev. Rul. 77-347, and likewise without any attempt to justify or explain the two reversals. *See* Brief for the Petitioner at 34 n.5. Thus, under the *Skidmore* standard, the fact that the IRS has not just once but twice reversed its position on the issue of whether benefits must be tied to state unemployment compensation benefits in order to be excluded from taxable wages for FICA purposes means that the current IRS position on this issue is entitled to very little if any weight.

Moreover, this is not the only issue on which the IRS has reversed its position on the requirements that must be satisfied in order for benefits to be excluded from taxable wages for FICA purposes. The IRS has also reversed its position, again not just once but twice, on the issue of whether benefits paid in a lump-sum can be excluded from taxable wages for FICA purposes. The benefits that were held to be excluded from taxable wages for FICA purposes in Rev. Rul. 56-249 were not paid in a lump-sum but were instead paid over time.

However, as the government acknowledges in its petition for certiorari, in Rev. Rul. 59-227, 1959-2 C.B. 13, the IRS reversed its position on whether

lump-sum payments can be excluded from taxable wages for FICA purposes by "explaining that the principles of the 1956 Revenue Ruling would apply with equal force to plans ... that made lump sum rather than periodic payments to employees." Petition at 12-13. In Rev. Rul. 90-72, the IRS took the opposite position on this issue, concluding that benefits paid in a lump sum do not satisfy the requirement that Rev. Rul. 90-72 imposed that benefits must be tied to state unemployment compensation benefits in order to be excluded from taxable wages for FICA purposes. 1990-2 C.B at 212. While the government's petition for certiorari acknowledges the initial reversal of position by the IRS on whether lump-sum payments can be excluded from taxable wages for FICA purposes (without acknowledging that it was a reversal), Petition at 12-13, the petition neither acknowledges nor attempts to explain the second IRS reversal of position on this issue. The government's brief in this Court ignores both reversals of position on this issue.

Thus, the IRS has reversed its position not just once but twice on not just one but two different issues concerning which benefits are excluded from taxable wages for FICA purposes. Under the *Skidmore* standard, this double reversal of position by the IRS on two different issues relating to which benefits can be excluded from taxable wages for FICA purposes makes it very difficult for the current IRS positions to receive any weight at all.

The other feature of the series of revenue rulings that seriously reduces the weight that is given to the positions expressed in these rulings is the lack of reasoning in the rulings to support the positions

expressed in the rulings. Rev. Rul. 56-249, the ruling that first held that certain supplemental unemployment compensation benefits could be excluded from taxable wages for FICA purposes, contained no reasoning at all. Instead, this ruling contained only an extensive description of the terms of the benefit plan that was at issue.

While Rev. Rul. 90-72, the latest ruling in this series, contained a small amount of reasoning, this reasoning was extremely superficial and conclusory. While this ruling expressed the position that benefits must be tied to state unemployment compensation benefits in order to be excluded from taxable wages for FICA purposes, the ruling did not explain the basis for this position, or for the position that benefits that are not tied to state unemployment compensation benefits cannot be excluded from taxable wages for FICA purposes. Moreover, neither the IRS nor the Justice Department has ever provided such an explanation.

Because of the substantial internal inconsistencies among the revenue rulings and because of the lack of any satisfactory explanation in these rulings for the positions they adopt, under *Skidmore*, these positions should be given very little weight in determining what supplemental unemployment compensation benefits are excluded from taxable wages for FICA purposes.

Moreover, not only are the revenue rulings inconsistent among themselves, the arguments the government makes in support of its position that the benefits at issue in this case are taxable wages for FICA purposes are also inconsistent with the terms of the rulings. The government contends that in

addition to the fact that wages are defined broadly for FICA purposes, additional factors supporting its position that the benefits at issue in this case are taxable wages for FICA purposes are the fact that the benefits at issue are based on the length of the employee's service with the company and the level of the employee's regular compensation: "[W]hen, as here, the amount of a payment to a departing employee is based on factors like the employee's salary and years of service to the company, those factors indicate that the payment is compensation for past services rendered by the employee." Petition at 23.

However, this argument by the government is in direct conflict with the terms of the revenue rulings that the government relies on as establishing the controlling tests for determining whether benefits are excluded from taxable wages for FICA purposes. Rev. Rul. 56-249 clearly states that the benefits that were at issue in that ruling were based in part on the duration of an employee's service with the employer and the level of the employee's regular compensation:

> The benefits payable from the fund are to be in varying amounts and for varying periods, depending on the size of the fund, duration of layoff of an employee, *time worked prior to layoff*, amount of State unemployment benefits available, *and the base hourly-rate of the individual employee*, less taxes withheld.

1956-1 C.B. at 490 (emphasis added).

Moreover, Rev. Rul. 90-72, which is the most recent in the series of rulings on this subject, in describing the relevant factors from Rev. Rul. 56-249,

explicitly included these same factors, noting that "the amount of weekly benefits payable is based [in part] upon ... the amount of straight-time weekly pay," and that "the duration of the benefits is affected by ... the employee's seniority." 1990-2 C.B. at 212. The government does not acknowledge or attempt to explain this serious inconsistency between its position in this case and the terms of the rulings it relies on as controlling on the issue of what benefits are excluded from taxable FICA wages as supplemental unemployment compensation benefits.

In light of this inconsistency, either the government's position in this case on the relevance of these factors is wrong or the revenue rulings are incorrect to conclude that benefits displaying these characteristics are excluded from taxable FICA wages. Either of these alternatives is obviously seriously damaging to the government's position in this case.

### C. Other flaws in government position

The government's briefs in the Sixth Circuit in this case seem to display a recognition of the weakness of the government's position that the revenue rulings on which the government relies establish the law regarding what supplemental unemployment benefits are excluded from taxable wages for FICA purposes. The government's briefs explicitly disavow any attempt to defend the correctness of the tests in the revenue rulings and instead devote all their attention to attacking the taxpayer's position that the statutory definition controls.

For example, the government asserts that "[t]he merits of the linkage requirement of Rev. Rul. 90-72 are not at issue here." Reply Brief for the Appellant at 32, *United States v. Quality Stores, Inc.*, 693 F.3d 605 (6th Cir. 2012) (No. 10-1563). Nevertheless, the government relies on the linkage requirement stated in Rev. Rul. 90-72 as part of the reason why the benefits at issue in this case supposedly do not qualify as supplemental unemployment compensation benefits that are not taxable wages for FICA purposes. Brief for the Appellant at 31-32, *Quality Stores*, (6th Cir. 2012) (No. 10-1563).

The government claims it is not asserting *Chevron* deference for the revenue rulings: "Debtors (and amici) argue at length that Rev. Rul. 90-72 and the other Revenue Rulings addressing SUB pay are not entitled to judicial deference ... but the Government has made no such argument before this Court." Reply Brief for the Appellant at 28, *Quality Stores*, (6th Cir. 2012) (No. 10-1563). *See also* Petition for Rehearing *En Banc* at 7, *Quality Stores*, (6th Cir. 2012) (No. 10-1563) ("[T]he Government has not argued for deference to the Revenue Rulings"). However, that claim is inconsistent with the government's arguments that the revenue rulings represented the "present law" that is described in the committee report relating to the enactment of the statutory definition: "[T]he Committee Report was merely reciting 'present law,' and the source of that 'present law' was the very Revenue Rulings that Debtors disavow." Reply Brief for the Appellant at 11, *Quality Stores*, (6th Cir. 2012) (No. 10-1563). *See also* Brief for the Appellant at 39, *Quality Stores*, (6th Cir. 2012) (No. 10-1563) ("[T]he statement [in

the committee report] was a recitation of 'present law,' which necessarily refers to the IRS's Revenue Rulings regarding SUB pay").

The government does not explain how it reconciles its claim that the revenue rulings represented the "present law" that the committee report described with the government's claim that it is not asserting *Chevron* deference for the revenue rulings. If the revenue rulings do not receive *Chevron* deference, as the government acknowledges they do not, it is not possible for the revenue rulings to represent law, since *Chevron* deference applies only to agency pronouncements that have the force of law and does not apply to agency pronouncements that do not have the force of law. *See Mead*, 533 U.S. at 226-27.

Thus, agency documents that do not receive *Chevron* deference necessarily do not have the force of law and could not possibly be the "present law" referred to in the committee report. The fact that the committee report preceded *Chevron* does not affect this analysis, since, as *Mead* makes clear, prior to *Chevron*, agency documents such as IRS revenue rulings were evaluated under *Skidmore*, which clearly does not accord the force of law to such documents.

The government's claim that it is not asserting *Chevron* deference for the revenue rulings is also inconsistent with the government's position that because the benefit plans at issue in this case do not satisfy the requirements reflected in the revenue rulings, the benefits paid under those plans do not qualify as supplemental unemployment compensation benefits that are excluded from

taxable FICA wages. Failure to satisfy the requirements reflected in the revenue rulings could have this consequence only if the revenue rulings established the law on this issue.

The section of the government's opening brief in the Sixth Circuit headed "Statement of the Issue" makes this tension clear:

> Whether the courts below erred in holding that the severance payments at issue, which admittedly did not qualify for exclusion from Federal Insurance Contributions Act tax under Rev. Rul. 90-72, 1990-2 C.B. 211 (excluding certain supplemental unemployment compensation benefits from FICA tax) nevertheless did not constitute "wages" for FICA tax purposes.

Brief for the Appellant at 3, *Quality Stores*, (6th Cir. 2012) (No. 10-1563). *See also id.* at 10 ("The Government noted that although certain types of SUB pay are excluded from FICA tax as a result of a series of IRS Revenue Rulings beginning with Rev. Rul. 56-249, 1956-1 C.B. 488, and culminating with Rev. Rul. 90-72, 1990-2 C.B. 211, the severance payments at issue did not qualify under Rev. Rul. 90-72 because, among other things, they were not dependent upon the receipt of state unemployment compensation") (describing argument made in the bankruptcy court).

It is clearly an essential part of the government's position that the benefits at issue in this case are taxable wages for FICA purposes to claim that the benefits do not qualify for exclusion from taxable wages for FICA purposes under the revenue rulings,

and consequently the status of the revenue rulings is clearly at issue in the case:

> Although the IRS has ruled, in Rev. Rul. 90-72, that dismissal payments that meet the requirements delineated therein are not subject to FICA tax, there is no dispute that the severance payments at issue do not qualify for such exclusion because they were not dependent upon eligibility for, or receipt of, state unemployment compensation.

*Id.* at 22. And yet the government has not presented any arguments as to why the position in the revenue rulings is controlling or correct but instead, as noted above, explicitly asserts that the correctness of the linkage requirement expressed in Rev. Rul. 90-72 is not at issue in this case.

The government's position that the revenue rulings establish the law is inconsistent with the terms of the revenue rulings themselves. The revenue rulings by their own terms do not purport to establish law. Thus, for example, the revenue rulings do not purport to establish a comprehensive set of rules to determine which benefit plans provide supplemental unemployment compensation benefits that will be excluded from taxable wages for FICA purposes and which benefit plans do not provide such benefits. The revenue rulings for the most part do not purport to say which of the factors is necessary for the result. Even with respect to the most contested factor, the link to state unemployment benefits, while Rev. Rul. 90-72 states that this link is necessary for the benefits to be excluded from taxable wages for FICA purposes, it does not explain what the nature of the link must be.

The government states that the revenue rulings have "carved out a limited exception for certain types of dismissal pay," *id.* at 22, 31, but does not attempt to justify the existence of this carve-out. Most provocatively, the government acknowledges that the existence of authority for the IRS to create this carve-out could be questioned, but dismisses this issue by noting that taxpayers have not complained about the IRS's creation of such a carve-out, only about the scope of the carve-out: "While one could argue ... that the IRS lacked authority to carve out an exclusion for SUB pay meeting the requirements of the Revenue Rulings in light of Congress's treatment of dismissal pay, taxpayers obviously have not clamored to do so inasmuch as the exclusion lowers their tax burden." Reply Brief for the Appellant at 10, *Quality Stores*, (6th Cir. 2012) (No. 10-1563).

The government may mean to suggest here that in defining such a carve-out from treatment as taxable FICA wages for certain supplemental unemployment compensation benefits, the IRS has simply allowed taxpayers a benefit to which they would not otherwise be entitled, and that taxpayers accordingly cannot complain about the terms of the benefit. But if the government were to take that position, the government has not explained what is the source of the IRS's authority to allow such benefits to certain taxpayers but not others, or what determines the propriety of the particular place at which the IRS has drawn the line between the benefits that are eligible for this IRS allowance to certain taxpayers and the benefits in the case of other taxpayers that are not eligible for this IRS

allowance. The failure of the IRS to provide such explanations would subject the positions taken in the revenue rulings to challenge under the Administrative Procedure Act's arbitrary and capricious standard by taxpayers whose benefit plans do not satisfy the requirements reflected in the revenue rulings. See 5 U.S.C. § 706(2)(A).

The government's equivocation on the status of the revenue rulings continues in its petition for certiorari. For example, the petition never asserts that Rev. Rul. 90-72 is *correct* in its position that benefits must be tied to state unemployment compensation benefits in order to be excluded from taxable wages for FICA purposes. Instead, the petition merely states that in Rev. Rul. 90-72, "the IRS *set forth* in detail *its position* on ... the criteria that govern the determination whether particular payments to terminated employees are FICA 'wages.'" Petition at 14 (emphasis added). Likewise, with respect to the IRS position stated in Rev. Rul. 90-72, the petition merely states that "*[u]nder that approach*, the severance payments at issue here clearly are not exempt from FICA taxation because they are wholly unconnected to state unemployment compensation." *Id.* (emphasis added).

However, in describing why the government believes section 3402(o) is not relevant, the petition for certiorari clearly relies on the revenue rulings as the reason why the government believes the benefits at issue in the case are not excluded from taxable wages for FICA purposes:

> The provision does not explicitly address, and has no logical bearing on, the determination whether particular payments

> to terminated employees are subject to FICA taxation. *Rather, that determination is governed by other provisions of law.* And, once Section 3402(o) is understood to be irrelevant to questions of FICA taxation, the severance payments at issue here clearly constitute FICA "wages." See pp. 8-14, *supra*.

*Id.* at 20 (emphasis added).

The pages in the petition that are cited here as support for the position that "the severance payments at issue here clearly constitute FICA 'wages'" conclude with the discussion of Rev. Rul. 90-72 that includes the statements quoted above. Thus, as in its briefs in the Sixth Circuit, the government's petition for certiorari adopts inconsistent positions on the status of the revenue rulings. The petition refrains from endorsing the positions in the revenue rulings as correct, while nevertheless relying on them as the basis for the position that the benefits at issue in the case are not excluded from taxable wages for FICA purposes, and even seems to refer to them as being in the category of "other provisions of law."

Thus, the government's position on the status of the revenue rulings remains as incoherent and unsupported in this Court as it was in the Sixth Circuit.

## IV. CONCLUSION

In the absence of any explanation of why the government believes a series of revenue rulings issued by the IRS are controlling on the issue of which supplemental unemployment compensation benefits are excluded from taxable wages for FICA purposes, or why the most recent of these revenue rulings concluded that, in order to be excluded, benefits must be tied to state unemployment compensation benefits, the government's position that the benefits at issue in the case cannot be excluded is incoherent and unsupported.

In contrast, the taxpayer has presented a very coherent, sensible, and easily understood explanation of the basis for its position, namely, that the statutory definition of supplemental unemployment compensation benefits should apply for FICA purposes as well as income tax withholding purposes because of the principle that there should be parallelism between what is considered wages for both sets of provisions. Given the choice between the taxpayer's coherent position and the government's incoherent position, it is clear that the taxpayer's position must be preferred.

Accordingly, the decision of the Sixth Circuit should be affirmed.

Respectfully submitted,

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# AMICUS CURIAE BRIEF

No. 12-1408

In The
# Supreme Court of the United States

UNITED STATES OF AMERICA,

*Petitioner,*

v.

QUALITY STORES, INC., ET AL.,

*Respondents.*

**On Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit**

## BRIEF OF AMERICAN PAYROLL ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS


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## QUESTION PRESENTED

Whether downsizing payments made to involuntarily terminated employees are "wages" subject to Federal Insurance Contributions Act (FICA) taxes.

TABLE OF CONTENTS

Page

Question Presented ..... i

Interest Of *Amicus Curiae* ..... 1

Introduction And Summary Of Argument ..... 2

Argument ..... 5

I. SUB Payments Are Not Remuneration For "Service" And So Are Not Wages Subject To FICA ..... 5

II. The Definition Of SUB Payments Set Forth By Congress In The Code Has Been Widely Applied By The Treasury Department, The IRS Itself, And Courts ..... 9

A. Congressional And Treasury Department Actions Show That SUB Payments Are Not Subject To FICA ..... 10

1. Initial Congressional Action ..... 10

2. Treasury Department Initiatives And The Congressional Response ..... 12

B. Contemporaneous IRS Publications Show That SUB Payments Are Not Subject To FICA ..... 19

C. Contemporaneous IRS Rulings Show That SUB Payments Are Not Subject To FICA ..... 21

D. Judicial Precedent Shows That SUB Payments Are Not Subject To FICA ..... 24

TABLE OF CONTENTS—Continued

Page

III. The IRS Does An About Face In 1990 And Begins Issuing Revenue Rulings That Contravene Decades Of Established Understanding And Consistent Practice..... 25

IV. The Government's Reliance On The 1983 "Decoupling Amendments" Is Misplaced..... 28

V. Congressional Acquiescence Shows Approval Of The SUB Payment FICA Exclusion..... 30

Conclusion..... 35

## TABLE OF AUTHORITIES

Page

CASES

*Accardi* v. *Pa. R.R. Co.*, 383 U.S. 225 (1966) .....6

*Bartels* v. *Birmingham*, 332 U.S. 126 (1947).....32

*Cent. Ill. Pub. Serv.* v. *United States*, 435 U.S. 21 (1978).....27, 28

*Chevron U.S.A., Inc.* v. *Nat. Res. Def. Council, Inc.*, 467 U.S. 837 (1984).....26

*Chrysler Corp.* v. *Brown*, 441 U.S. 281 (1979).....17

*Coffy* v. *Republic Steel Corp.*, 447 U.S. 191 (1980).....*passim*

*Comm'r* v. *Schleier*, 515 U.S. 323 (1995).....26

*Cottage Sav. Ass'n* v. *Comm'r*, 499 U.S. 554 (1991).....31

*CSX Corp.* v. *United States*, 518 F.3d 1328 (Fed. Cir. 2008).....27, 28, 31

*Davis* v. *United States*, 495 U.S. 472 (1990).....26, 32

*Dixon* v. *United States*, 381 U.S. 68 (1965).....16

*Gen. Elec. Co.* v. *Gilbert*, 429 U.S. 125 (1976).....26

*Hardt* v. *Reliance Standard Life Ins. Co.*, 560 U.S. 242 (2010).....5

*McLaren* v. *Fleischer*, 256 U.S. 477 (1921) .....32

*Norwegian Nitrogen Prods. Co.* v. *United States*, 288 U.S. 294 (1933).....32

*NYSA-ILA Container Royalty Fund* v. *Comm'r*, 847 F.2d 50 (2d Cir. 1988).....6, 24, 25, 27

TABLE OF AUTHORITIES—Continued

Page

*Rowan Cos.* v. *United States*, 452 U.S. 247 (1981) ..... *passim*

*Skidmore* v. *Swift & Co.*, 323 U.S. 134 (1944) ..... 26

*Soc. Sec. Bd.* v. *Nierotko*, 327 U.S. 358 (1946) ..... 5

*United Housing Found., Inc.* v. *Forman*, 421 U.S. 837 (1975), *superseded on other grounds by* 92 Stat. 2076, 42 U.S.C. § 2000e(k) ..... 26

*United States* v. *Cleveland Indians Baseball Co.*, 532 U.S. 200 (2001) ..... 31, 33

*United States* v. *Correll*, 389 U.S. 299 (1967) ..... 31

*United States* v. *Mead Corp.*, 533 U.S. 218 (2001) ..... 26

*Zenith Radio Corp.* v. *United States*, 437 U.S. 443 (1978) ..... 31

STATUTES AND RULES

26 U.S.C. § 1 *et seq.*, Internal Revenue Code of 1986 ..... *passim*

26 U.S.C. § 419A ..... 8, 33

26 U.S.C. § 501 ..... *passim*

26 U.S.C. § 3121(a) ..... 5, 29

26 U.S.C. § 3121(b) ..... 5, 29

26 U.S.C. § 3304 ..... 23

26 U.S.C. § 3402 ..... *passim*

26 U.S.C. § 6041 ..... 12, 13, 19

TABLE OF AUTHORITIES—Continued

Page

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N.Y. LAWS § 601 (LexisNexis 2013).....23

TEX. CODE ANN. § 209.047 (LexisNexis 2013).....23

OTHER AUTHORITIES

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Treas. Reg. § 1.501(c)(17)-2 (1970).....11, 13

Treas. Reg. § 1.6041-2 (2004) .....13, 14, 18

Treas. Reg. § 31.3401(a)-1 (2007).....8

Rev. Rul. 56-249, 1956-1 C.B. 488.....22, 28

Rev. Rul. 58-128, 1958-1 C.B. 89.....21

Rev. Rul. 60-330, 1960-2 C.B. 46.....*passim*

Rev. Rul. 77-347, 1977-2 C.B. 362.....21, 25, 26, 32

Rev. Rul. 80-124, 1980-1 C.B. 212.....22

Rev. Rul. 90-72, 1990-2 C.B. 211.....*passim*

T.D. 6972, 1968-2 C.B. 222.....13

T.D. 7068, 1970-2 C.B. 252.....17

I.R.S. Tech. Adv. Mem. 79-37-003 (May 30, 1979)..... 24

I.R.S. Form 941, *Employer's Quarterly Federal Tax Return*.....18, 19, 20

I.R.S. Form 941E, *Quarterly Return of Withheld Federal Income Tax* .....20

TABLE OF AUTHORITIES—Continued

Page

I.R.S. Pub. 15 (Circular E), *Employer's Tax Guide* (1971) ..... 19, 20

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S. Rep. 91-552, *reprinted in* 1969 U.S.C.C.A.N. 2027 ..... 15, 16, 32

79 Cong. Rec. 9349 (1935) ..... 11

Emerson H. Beier, *Financial Supplemental Unemployment Benefit Plans*, MONTHLY LAB. REV. 31 (Nov. 1969) ..... 12, 24

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## INTEREST OF *AMICUS CURIAE*[1]

The American Payroll Association (APA) is the Nation's leading private-sector advocate for payroll issues. A nonprofit association, the APA represents 21,000 payroll professionals who perform payroll processing services for over 17,000 employers, and for the major payroll service providers in the United States who in turn process payrolls for an additional 1.5 million employers.

As payroll specialists, the APA's members determine proper employment tax withholding; prepare and file accurate information returns and statements; correct (when necessary) those returns and statements; calculate and deposit taxes; and maintain payroll records.

The APA thus has a significant interest in the outcome of this case because many of its members process downsizing payments like the ones at issue here that constitute supplemental unemployment compensation benefits under the Internal Revenue Code of 1986, as amended, 26 U.S.C. § 1 *et seq.* (the Code). An easily administrable rule is crucial in this context—and as this Court recognized in *Rowan Cos.*

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[1] Pursuant to Rule 37.6, the *amicus* submitting this brief and their counsel hereby represent that neither the parties in this case nor their counsel authored this brief in whole or in part, and that no person other than *amicus* paid for or made a monetary contribution toward the preparation or submission of this brief. *Amicus* file this brief with written consent from all parties, copies of which are on file in the Clerk's Office.

v. *United States*, 452 U.S. 247 (1981), Congress's intention to have "wages" carry the same meaning for purposes of both the Federal Insurance Contributions Act (FICA) and federal income-tax withholding (FITW) promotes "simplicity and ease of administration." *Id.* at 257.

Accepting the government's contrary argument here would create a great deal of confusion for APA members in that doing so would result in an administrative quagmire for multi-state employers which would end up with different federal payroll rules in different jurisdictions. Furthermore, if taken to its logical conclusion, the government's position that all downsizing payments should be deemed "wages" would have the far-reaching consequence of disqualifying unemployed workers from receiving state unemployment benefits—because those benefits are contingent on the downsizing payments not being "wages." Because the text, structure, purpose, and history of the pertinent statutes and regulations does not permit—much less require—such an untoward result, the decision below should be affirmed.

## INTRODUCTION AND SUMMARY OF ARGUMENT

The court of appeals correctly held that, when an employer undergoes downsizing, payments made to terminated employees constitute supplemental unemployment compensation benefits or "SUB

payments." And as defined by Congress in the Code, SUB payments are not taxable as "wages" under FICA. That construction is consistent with the statutory language, the pertinent regulations, and the relevant legislative history. It is consistent with this Court's instruction in *Rowan* that, given the similarity in the statutory definitions, the term "wages" should be construed the same way for purposes of both FICA and FITW.[2] And it is consistent with this Court's teaching in *Coffy* v. *Republic Steel Corp.*, 447 U.S. 191, 200 (1980), that SUB payments are not wages because they fall outside the statutory meaning of "service" performed by an employee for an employer—by definition, an employee is not eligible for SUB payments until service to the employer has ended.

The issue before the Court is how SUB payments should be defined. For decades, Congress, the Treasury Department, the IRS, and the courts uniformly adopted the definition of "supplemental unemployment compensation benefits" that Congress set forth in §§ 3402(o)(2)(A) & 501(c)(17)(D) of the Tax Code as benefits "which are paid to an employee because of his involuntary separation from the employment of the employer (whether or not such separation is temporary) resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions." These benefits were not treated as

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[2] The definition would necessarily be the same for purposes of the Federal Unemployment Tax Act (FUTA).

wages for FICA purposes. Now, the government urges that "for FICA and FUTA purposes," SUB payments should be defined "solely through a series of administrative pronouncements" by the IRS that, among other things, depart from the IRS's own longstanding position that the receipt of state unemployment benefits is immaterial to the analysis, and instead requires some sort of (undefined and unexplained) connection between SUB payments and the actual receipt of unemployment benefits. Rev. Rul. 90-72, 1990-2 C.B. 211.

But none of those administrative pronouncements has the force of law, and none addresses the pertinent Treasury Department regulations that have never defined SUB payments in the way urged by the government. Simply put, the inconsistent IRS rulings cannot overcome the plain language of the statute, the governing Treasury Department regulations, the IRS's own contemporaneous publications and forms, or this Court's decisions in *Coffy* and *Rowan*.

The government's position, if accepted, would thus replace the straightforward definition provided by Congress with a cumbersome and essentially unadministrable definition. Among other things, it would require that the payments must be "designed to *supplement* the receipt of state unemployment compensation," Rev. Rul. 90-72 (emphasis added), but provides no guidance as to even the most basic state unemployment elements such as the applicable waiting periods, registration requirements, the impact of part-time employment, or the amount of

permissible SUB payments. Forcing employers to deal with multiple state unemployment regimes to determine federal payroll tax obligations imposes a heavy administrative burden on even the most sophisticated multi-state employers.

In sum, the construction urged by the government in this case is not only contrary to statutory text, congressional purpose, and governing regulations, but also manufactures a definition of "wages" that is imprecise, speculative, varies state by state, and, as a practical matter, injects considerable confusion and uncertainty into the administration of payrolls. That construction should be rejected and the decision below affirmed.

## ARGUMENT

### I. SUB Payments Are Not Remuneration For "Service" And So Are Not Wages Subject To FICA

We begin, as we must, with the plain language of the statute and construe it according to its plain and ordinary meaning. *Hardt* v. *Reliance Standard Life Ins. Co.*, 560 U.S. 242, 251 (2010). FICA taxes are imposed on "wages," which include "all remuneration for employment" performed by employees for their employers. 26 U.S.C. § 3121(a). "Employment," in turn, is defined as "any *service*, of whatever nature." 26 U.S.C. § 3121(b) (emphasis added). Although the government is correct that the term "wages" is construed broadly for FICA purposes, *Soc. Sec. Bd.* v.

*Nierotko*, 327 U.S. 358, 365-66 & n.17 (1946), the term is not unlimited.

SUB payments are not wages because they are not remuneration for past, present, or future service. They are just the opposite, as this Court recognized in *Coffy*, because they are "contingent on the employee's being thrown out of work; unless the employee is laid off he will never receive SUB payments * * * they are 'compensation for loss of jobs'" rather than "compensation for work performed." 447 U.S. at 200 (quoting *Accardi* v. *Pa. R.R. Co.*, 383 U.S. 225, 230 (1966)). That is why the government was correct previously in arguing that SUB payments and wages are "mutually exclusive" for payroll tax purposes—a position diametrically opposed to that taken by the government here. Compare *NYSA-ILA Container Royalty Fund* v. *Comm'r*, 847 F.2d 50, 53 (2d Cir. 1988), with Br. 19.

That construction only makes sense given the purpose of SUB payments. Employers make SUB payments only when a worker is *prevented* from performing services as a direct result of downsizing, reductions in force, or layoffs. SUB payments thus do not provide remuneration for service. Instead, as the IRS itself has recognized in the past, they help "promote the welfare of employees laid off." Rev. Rul. 60-330, 1960-2 C.B. 46. SUB payments do that by bridging the gap between periods of employment—a gap that employers and the government both

understand can involve financial hardships on laid-off workers.[3]

Consistent with the understanding of SUB payments articulated by this Court in *Coffy*, Congress, the Treasury Department, and the IRS itself have long recognized SUB payments as a separate and unique category expressly defined for tax purposes: by Congress in the Code; by the Treasury Department in regulations; and by the IRS in rulings, forms, and publications. Linking the payments to job elimination is consistent with this Court's holding in *Coffy* that SUB payments do not constitute "compensation for work performed." 447 U.S. at 200. And under this Court's decision in *Rowan*, the corresponding exclusion from "wages" should be consistently applied for all relevant purposes under FICA, FUTA, and FITW. 452 U.S. at 254.

Now, however, after more than a half century of uniform recognition that SUB payments are a distinct category of payments, the government seeks to lump SUB payments together with all severance and dismissal payments and then argue that SUB payments must be wages unless a statutory exception

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[3] The Congressional Budget Office has analyzed the financial hardships downsized workers face in terms of employment opportunities, earnings potential, health insurance coverage, and unemployment insurance. Molly Dahl & Joyce Manchester, *Losing a Job During a Recession*, CBO Economic & Budget Issue Brief (2010), http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/114xx/doc11429/jobless_brief.pdf.

says they are not. That position, however, cannot be reconciled with this Court's decisions in *Coffy* and *Rowan*, with the plain language of the statute, with the legislative history, with the Treasury Department regulations, or even with some of the IRS's own previous pronouncements and rulings.

Dismissal pay and SUB payments are not synonymous. First, if SUB payments were merely a subset of dismissal pay for FICA purposes (as the government would have it), then it would have been unnecessary for Congress to enact § 3402(o). That section provides for income-tax withholding on SUB payments—an obvious redundancy because dismissal pay is already included under wages and would not need another withholding provision. Second, dismissal pay and SUB pay are treated differently—indeed, as mutually exclusive—by the Treasury Department's FITW regulations. Compare Treas. Reg. § 31.3401(a)-1(b)(4) (2007), with Treas. Reg. § 31.3401(a)-1(b)(14) (2007). And so it also would have been unnecessary for the Treasury Department to issue Treas. Reg. § 31.3401(a)-1(b)(14) because "present law" at the time already included (not excluded) SUB pay as wages.[4]

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[4] Treas. Reg. § 31.3401(a)-1(b)(14)(i) provides: "Supplemental unemployment compensation benefits paid to an individual after December 31, 1970, shall be treated (for purposes of the provisions of Subparts E, F, and G of this part which relate to withholding of income tax) as if they were wages, to the extent such benefits are includible in the gross income of such individual." See also 26 U.S.C. § 419A(f)(1) and Treas. Reg. § 1.419A-1T (1986) (separately defining SUB payments and severance).

## II. The Definition Of SUB Payments Set Forth By Congress In The Code Has Been Widely Applied By The Treasury Department, The IRS Itself, And Courts

As explained above, there is no dispute that SUB payments have been excluded from "wages" for FICA purposes for more than half a century. The government cites no authority—and we are aware of none—holding to the contrary. Although the government queries whether the IRS had the authority to exclude *any* SUB payments from FICA, Br. 30, that proposition lacks support. Even the government concedes, as it must, that "Congress effectively acquiesced" in the SUB payments wage exclusion. *Ibid.* The question is how to define SUB payments for purposes of applying the wage exclusion, i.e., whether the term "SUB payments" should be defined by reference to a series of IRS administrative rulings, as the government urges, or by reference to the Tax Code and Treasury Department regulations, as respondent argues (and *amicus* APA agrees).

Although the government (at 21) faults the court of appeals for "misunderstanding[ ]" the "text, history, and purpose" of § 3402(o)—which sets out the statutory definition of SUB payments—and criticizes respondents (at 35) for not offering a "reasonable alternative explanation" of the statute's "origin or purpose" that supports the position that the statutory definition should control, it appears to be the government that has misunderstood the relevant authorities, including its own regulations, rulings, and forms.

### A. Congressional And Treasury Department Actions Show That SUB Payments Are Not Subject To FICA

#### 1. Initial Congressional Action

In 1960, Congress enacted § 501(c)(17) to extend tax-exempt status to the trusts used to fund SUB payment benefits. (Although trust funds were initially one of the factors identified by the IRS in its rulings as required for FICA exemption, that factor was soon eliminated from consideration by the IRS in Rev. Rul. 60-330, and has been considered irrelevant ever since.)

Congress was aware that the IRS developed, in revenue rulings, an administrative definition of SUB payments under which the payments "are taxable to the recipients as income (although not generally subject to withholding)."[5] Congress declined, however, to define SUB payments in the same manner as the IRS rulings. Instead, in § 501(c)(17)(D)(i), Congress defined "supplemental unemployment compensation benefits" as:

> [B]enefits which are paid to an employee because of his *involuntary separation from the employment of the employer* (whether or not such separation is temporary) *resulting directly from* a reduction in force, the

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[5] S. Rep. 86-1518, *reprinted in* 1960 U.S.C.C.A.N. 3203, 3204.

> discontinuance of a plant or operation, or other similar conditions.

(Emphases added). Under this statutory definition, downsized employees can continue to receive SUB payments even if the employees obtain other employment after they are terminated. That is consistent with the legislative judgment in enacting the Social Security Act of 1935 that "prevention of unemployment is very much more important than compensation for unemployment." 79 Cong. Rec. 9349, 9361 (1935). Congress thus wanted to provide every incentive to encourage reemployment rather than provide any incentive to stay unemployed—and requiring ongoing unemployment as a condition for SUB payments, as the government would have it, could thwart that legislative purpose by acting as a disincentive to timely reenter the workforce.[6]

In the seven years after Congress enacted the statutory definition of SUB payments in § 501(c)(17),

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[6] The House bill would have defined SUB payments as "benefits which are paid to an employee because of his involuntary unemployment (whether or not temporary) resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions." S. Rep. 86-1518, *reprinted in* 1960 U.S.C.C.A.N. at 3207. As enacted, however, the phrase "involuntary unemployment" was replaced with the phrase "involuntary separation from the employment of the employer." *Id.* at 3210-11. Similarly, the Treasury Department issued regulations authorizing SUB payments to "an employee who has, subsequent to his separation from the employment of the employer, obtained other part-time, temporary, or permanent employment." Treas. Reg. § 1.501(c)(17)-2(a).

employers expanded SUB payment arrangements to cover more than 2.5 million workers—primarily in the automobile, steel, rubber, and garment industries. Trust funds were initially used "almost without exception" to fund these large-scale financial obligations simply because "pay-as-you-go financing could inflict an excessive burden on the employer's working capital." Emerson H. Beier, *Financial Supplemental Unemployment Benefit Plans*, MONTHLY LAB. REV. 31, 31 (Nov. 1969). Although the trusts were required to perform all payroll-tax and information-reporting functions, the IRS had not issued guidance on the required payroll tax administration.

### 2. Treasury Department Initiatives And The Congressional Response

By 1968, tax administration had become a significant issue because, even though SUB payments were universally excluded from wages for purposes of FICA, FUTA, and FITW—as discussed *infra*—SUB payments were still subject to federal income taxes. As a result, recipients of SUB payments frequently found themselves with insufficient funds to pay their income taxes when they filed their year-end returns.

To address that situation, the Treasury Department undertook three coordinated payroll tax initiatives from 1968 to 1970: (1) it issued final information-reporting regulations under § 6041 confirming that SUB payments from any trust are reportable only on Forms 1099 (and thus are not wages); (2) it sought guidance from Congress on SUB payment

income-tax withholding; and (3) it issued regulations governing the information reporting of SUB payments in response to the congressional guidance. The government's brief references the second (legislative) initiative but fails to mention the first and third (regulatory) initiatives—a significant omission, as the reporting regulations are key to understanding the "present law" referenced by Congress in the legislative history when it enacted § 3402(o) in the first instance. The initiatives reflect a position at odds with the government's current argument.

As for the first initiative, section 6041 requires payers to "render a true and accurate return to the Secretary, under such regulations and in such form and manner and to such extent as may be prescribed by the Secretary." The 1968 "legislative" regulations—issued by the Treasury Department under this specific delegation of authority—address the information and payroll tax requirements for SUB payments under both §§ 501(c)(17) and 6041. These final regulations required Form 1099 information-reporting of SUB payments of $600 or more—and thus contemplate that SUB payments are excluded from wages for both FICA and FITW purposes. Treas. Regs. §§ 1.501(c)(17)-2(j) & 1.6041-2(b); see T.D. 6972, 1968-2 C.B. 222.

Forms 1099 are used to report income—and it has never been permissible for FICA taxes to be reported or withheld on Forms 1099. It is equally well established for information-reporting and tax-withholding purposes that Forms W-2, *Employee Wage and Tax Statement*, are used in lieu of Forms

1099 to report *both* FICA wages and FITW wages. Treas. Reg. § 1.6041-2(a). If SUB payments were wages (as the government now argues), reporting them on Form 1099 would have been impermissible.

Given the mandatory Form 1099 reporting imposed by the Treasury Regulations without any corresponding wage withholding, the Treasury Department not only recognized the amounts were exempt from FICA taxes, but it also precluded the amounts from being reported and withheld as wages for any employment-tax purpose covered by Subtitle C of the Code—including FICA. If the Treasury Department believed, as the government now insists, that all or even some portion of SUB payments were wages for FICA purposes, then it would have imposed the corresponding information-reporting and income-tax withholding requirements on Forms W-2. That it did not only reinforces that SUB payments, as defined in the Code, were excluded from wages for all employment-tax purposes in Subtitle C of the Code.

With respect to the second initiative, the Treasury Department asked Congress to address the significant income-tax payment issues by granting the Department authority to issue regulations permitting voluntary income-tax withholding. Instead, Congress intervened more directly by enacting § 3402(o), which imposed mandatory income-tax withholding by deeming SUB payments to be wages for FITW purposes—even though only a year earlier the Treasury Department had excluded such amounts from Form W-2 reporting and instead imposed Form 1099 reporting.

More specifically, section 3402(o) imposed income-tax withholding on SUB payments while recognizing that "although these benefits are not wages" they are "generally taxable income to the recipient" and "the absence of withholding on these benefits may require a significant final tax payment by the taxpayer receiving them." S. Rep. 91-552, *reprinted in* 1969 U.S.C.C.A.N. 2027, 2305. For purposes of imposing mandatory income-tax withholding, then, Congress defined SUB payments by adopting almost verbatim the definition of SUB payments set out in § 501(c)(17). Therefore, any payment that falls within that definition of a SUB payment shall be treated as if it were a payment of wages *solely* for FITW purposes.

The regulatory background and legislative history thus confirm what the text of the statute makes plain—SUB payments are not remuneration for services and are therefore excluded from wages for all Subtitle C purposes (i.e., FICA). As the Senate Report explained:

> *Present law*—Under present law, supplemental unemployment benefits are not subject to withholding *because they do not constitute wages or remuneration for services.*
>
> General reasons for change—[SUB payments] by employers are generally taxable income to the recipient. Consequently, the absence of withholding on these benefits may require a significant final tax payment by the taxpayer receiving them. The committee concluded that *although these benefits are not wages,*

> since they are generally taxable payments they should be subject to withholding to avoid the final tax payment problem for employees.

*Ibid.* (emphases added). The Senate Report concluded that "[t]he withholding requirements applicable to withholding on wages are to apply to these non-wage payments." *Id.* at 2306. As the court of appeals correctly concluded, the "necessary implication" of the italicized language is that "Congress did not consider [such] payments to be 'wages' but allowed their treatment as wages to facilitate federal income tax withholding." Pet. App. 11a-12a. If Congress intended to indicate that some of the payments described as "other than wages" actually were wages, it knew how to do so. But it did not, and as a consequence, *all* SUB payments, without distinction, are something "other than wages."

The government, however, contends (at 25) that the Senate Report's discussion of "present law" is "best understood to refer (somewhat imprecisely) to a series of IRS Revenue Rulings." "Somewhat imprecisely" indeed. The Senate Report is not obliquely referencing IRS rulings (which, after all, do not have the force of law) but Treasury Department regulations (which do) and under which all SUB payments, as defined in the Code, were exempt for FICA and FITW purposes. Particularly given that only four years earlier this Court had made plain that revenue rulings are no more than the opinions of the IRS, and lack the force and effect of law, *Dixon* v. *United States*, 381 U.S. 68, 73 (1965), Congress could not have considered the

revenue rulings relied upon by the government to be the "present law." In contrast, the Treasury Department's contemporaneous legislative regulations have the "force and effect of law," *Chrysler Corp.* v. *Brown*, 441 U.S. 281, 295 (1979), the same as the Code itself—and therefore comprise the "present law" referenced in the Senate Report.

As to the third initiative, the Treasury Department promulgated regulations the next year implementing the non-wage treatment of SUB payments as defined in the Code.[7] Specifically, the Treasury Department had to consider an alternative method for implementing § 3402(o)'s mandatory withholding because the mandatory Form 1099 reporting at that time did not contemplate or allow wage withholding for any Subtitle C purposes. New Treasury Department regulations issued in 1970 thus imposed the only method of information reporting available—Form W-2 reporting. See T.D. 7068, 1970-2 C.B. 252.[8]

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[7] Although the original exclusion contemplated SUB payments from trusts because they were the typical payors, even at that time there were non-trust payors, and the IRS eliminated that factor three years after recognizing its relevance. Rev. Rul. 60-330. Even under the government's most recent interpretation, the government concedes a trust is not required. *Ibid.*; Rev. Rul. 90-72.

[8] Not only are these regulations still in force, but also Form 1099 reporting is still required in certain situations where terminated workers receive amounts to which FITW is inapplicable. For example, a worker receiving a nominal SUB payment amount in the year following involuntary termination may be

(Continued on following page)

Mandatory Form W-2 reporting replaced Form 1099 reporting for SUB payments (as defined by the Code) paid after December 31, 1970, but only in response to and for the limited purpose of satisfying § 3402(o)'s deemed wage treatment, i.e., only for FITW purposes. See Treas. Regs. §§ 1.501(c)(17)-2(j) & 1.6041-2(b).[9]

But for § 3402(o), SUB payments retain their actual character as non-wages for FITW withholding and information-reporting purposes, further confirming that SUB payments similarly retain their status as non-wages for FICA purposes regardless of § 3402(o).

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exempt from actual FITW due to the number of personal allowances claimed on Form W-4, *Employee's Withholding Allowance Certificate*; therefore the worker would be issued a Form 1099 rather than a W-2 because these payments are understood not to be FICA wages.

[9] As already explained, the 1968 and 1970 reporting regulations specifically mention trusts because they were invariably used at the time to fund such large-scale payments. Other payors were not meant to be excluded. In the event that SUB payments were made directly by employers, Form W-2 reporting was already used—the amounts were simply not reported as wages. When Congress imposed mandatory FITW withholding on SUB payments, the 1968 regulations were rendered moot and SUB payments became reportable on Forms W-2, but not as wages. The upshot is that there was no need to issue regulations for non-trust payors because they already used Forms W-2 for federal income-tax withholding. In 1971, the IRS issued instructions to Forms W-2 and 941 explaining that despite the enactment of § 3402(o)(2), SUB pay was still not "wages" for FICA purposes.

### B. Contemporaneous IRS Publications Show That SUB Payments Are Not Subject To FICA

As a matter of practice, the IRS's own contemporaneous forms confirm the conclusion that SUB payments are non-wages for purposes of FICA.

After the Treasury regulations were promulgated, the IRS issued Form 941, *Employer's Quarterly Federal Tax Return*, and Publication 15 (Circular E), *Employer's Tax Guide*, under the authority delegated to the Treasury Department by § 6041 for "true and accurate return[s] * * * in such form and manner and to such extent as may be prescribed by the Secretary." Among other payroll functions, these forms explain and implement § 3402(o)'s deemed FITW wage inclusion and the corresponding FICA wage exclusion for SUB payments.

The Circular E, *Employer's Tax Guide*—considered the Bible of payroll administrators—is issued annually by the IRS to provide a summary of the withholding, depositing, paying, and reporting requirements for FICA, FUTA, and FITW purposes. The front page of the 1971 Circular E alerts employers that income-tax withholding is required on SUB payments *after* December 31, 1970. Circular E specifically adopts the definition of SUB payments set forth in the Code and provides that SUB payments are exempt from FICA and FUTA, but subject to income-tax withholding. Circular E (1971) at 5, 16. All payors of SUB payments were advised to issue copies of Forms W-2 "as if wages had been paid." *Id.* at 9.

Circular E warns employers to "not include the amount of any * * * *supplemental unemployment compensation benefit* from which income tax has been withheld." *Id.* at 12 (emphasis added).

Form 941, *Employer's Quarterly Federal Tax Return*, is used by employers and payroll administrators to deposit and report both FICA and FITW tax amounts to the IRS. The General Instructions reflect § 3402(o) and advise that FITW includes SUB payments. The Specific Instructions, in turn, require employers and payroll administrators to include SUB payments in withheld deposit amounts for FITW purposes but caution employers to exclude those same amounts from taxable FICA and FITW wages. Form 941 at 4.

Form 941E, *Quarterly Return of Withheld Federal Income Tax*, was created for entities that report FITW but are otherwise exempt from FICA taxes. The Form applies to SUB trusts and allows them to report FITW amounts. No FICA taxes were or could be reported, withheld, or deposited on the Form 941E. As with the Form 941, it provides that SUB payments should be excluded from the "wages" in Item 1, but the actual amount of income taxes withheld on SUB payments should be included in Item 2. Form 941E, Specific Instructions at 4. Therefore, even though the amounts were now "wages" under § 3402(o), the forms did not treat them as wages but only tracked the income taxes that were required to be withheld for FITW purposes.

In sum, in its early forms that employers use to guide them in filing taxes, the IRS instructed employers that to prevent payees from facing end-of-the-year tax liability on SUB payments, income taxes had to be withheld. Critically, however, the forms did *not* contemplate FICA withholding.

### C. Contemporaneous IRS Rulings Show That SUB Payments Are Not Subject To FICA

Contemporaneous IRS revenue rulings similarly comport with the statutory definition of SUB payments set forth in the Code. In 1977's Rev. Rul. 77-347, 1977-2 C.B. 362, for example, for SUB payments to be exempt from FICA, three conditions must be satisfied. First, the employee must involuntarily lose employment under the conditions imposed by the Code's definition of SUB payments. Second, the benefits must be computed based upon years of service and the employee's weekly earnings. Third, the benefits must not disqualify the terminated employee from receiving unemployment benefits.[10]

Although not a model of clarity (a common feature of the IRS SUB payment rulings), the ruling appears to indicate that if the payments merely satisfy § 3402(o), then they are excluded from wages for FICA

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[10] Contrary to the government's position now, the IRS in earlier revenue rulings made clear that the existence of a union-negotiated arrangement and a trust were irrelevant. See Rev. Rul. 58-128, 1958-1 C.B. 89, and Rev. Rul. 60-330, respectively.

purposes (but are deemed wages for FITW purposes). The tie or link to unemployment benefits is thus "not a material or controlling factor" when determining whether a SUB payment is exempt from FICA taxes.

Similarly, another revenue ruling (on the payroll tax implications of a voluntary pre-retirement leave plan), in contrast to the two revenue rulings relied upon by the IRS for purposes of its own most-recent definition of SUB payments, provides:

> In order for a payment to qualify as a supplemental unemployment benefit payment under Rev. Rul. 56-249 and Rev. Rul. 60-330, the employee must have no right, title, or interest in the payment or the company contribution to provide the payment until the employee is laid off, and the payment must be made for a layoff that is involuntary on the part of the employee * * * * Both Code sections [501(c)(17) and 3402(o)] provide that the payment must be based on the involuntary separation of an employee from the employment of the employer only when such separation is one resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar condition.

Rev. Rul. 80-124, 1980-1 C.B. 212. Contrary to the government's current position, the IRS's position in the above rulings with respect to defining SUB payments—and consistent with the statutory definition of SUB payments—requires neither a trust nor a

connection to state unemployment benefits." It is also consistent with leading SUB plan practices in 1969 (when § 3402(o) was enacted) that did not link SUB payments to state unemployment benefits. For example, among the earliest SUB plans were those

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" To the extent a connection between SUB payments and unemployment benefits is even required, it already exists. Congress and state legislatures specifically recognize that terminated employees may simultaneously receive SUB payments as defined by Congress and extended state unemployment benefits—therefore, SUB payments as defined by Congress already have a connection to state unemployment benefits through FUTA, which imposes on the States a requirement that extended unemployment compensation must "be payable as provided by the Federal-State Extended Unemployment Compensation Act [FSEUCA] of 1970." 26 U.S.C. § 3304(a)(11). FSEUCA, in turn, pays extended unemployment benefits during periods of heavy and ongoing unemployment—including payments to many unemployed workers who are receiving SUB payments as defined by Congress. That definition is one component used by FSEUCA and § 3304(a)(11) to determine whether terminated workers are eligible for extended unemployment benefits. Again, we do not believe that a connection between SUB payments and unemployment benefits is required for SUB payments to be exempt from FICA taxation, but even if it were, that connection already exists and thus provides no reason to accept the IRS's definition of SUB payments. Indeed, virtually all 50 states—including the five largest—satisfy the FUTA requirement by specifically linking Congress's definition of SUB payments with their own statutory framework for extended unemployment benefits. See, e.g., CAL. UNEMP. INS. CODE § 4553(b) (Deering 2013); FLA. STAT. § 443.1115 (LexisNexis 2013); 805 ILL. COMP. STAT. 405/409(K)(3) (2013); N.Y. LAWS § 601 (LexisNexis 2013); TEX. CODE ANN. § 209.047 (LexisNexis 2013). Hence the government's concession (at 29) that state unemployment benefits would be denied if SUB payments were "wages."

for members of the United Auto Workers (which accounted for more than 30% of SUB participants in 1967). Beier, *supra* 12, at 31, 33. These UAW plans made SUB payments to downsized workers even though they were ineligible for state unemployment benefits for reasons such as refusal to accept available work, refusal to be available for work, and earnings above the unemployment-insurance limits.

### D. Judicial Precedent Shows That SUB Payments Are Not Subject To FICA

The inconsistency in the government's positions does not stop with the revenue rulings. In *NYSA-ILA Container Royalty Fund* v. *Commissioner*, 847 F.2d 50 (2d Cir. 1988), the government asserted a position directly contrary to those it now pursues before this Court. In that case, the IRS had issued a Technical Advice Memorandum determining that the payments at issue "constitute supplemental unemployment benefits *within the meaning of Section 501(c)(17) and, therefore, are not wages for purposes of the FICA and the FUTA*." I.R.S. Tech. Adv. Mem. 79-37-003 (May 30, 1979) (emphasis added). The taxpayer subsequently filed and lost a refund suit seeking to extend the IRS's adoption of the statutory definition of SUB payments to benefits provided to dockworkers whose hours were reduced.

On appeal to the Second Circuit, the taxpayer contended that the benefits were SUB payments under § 3402(o) and, therefore, were excluded from "wages" for FICA and FUTA purposes. Contrary to its position

here, the government argued there that SUB payments and "wages" are "mutually exclusive." *NYSA-ILA*, 847 F.2d at 53. The Second Circuit agreed and, applying the definition of SUB payments in § 501(c)(17), recognized statutory SUB payments so defined are not subject to FICA, FUTA, or income-tax withholding. *Ibid.* Regarding income-tax withholding, the Second Circuit noted such statutory SUB payments became subject to FITW after 1970 because of § 3402(o). *Id.* at 52.[12]

## III. The IRS Does An About Face In 1990 And Begins Issuing Revenue Rulings That Contravene Decades Of Established Understanding And Consistent Practice

In 1990, the IRS jettisoned decades of common understanding and practice when it issued a revenue ruling opining that § 3402(o) is irrelevant to defining SUB payments and, instead, "[f]or FICA and FUTA purposes, SUB Pay is defined *solely* through a series of administrative pronouncements published by the Service." Rev. Rul. 90-72 (emphasis added). Further, the ruling sought to alter the IRS's previous position (set out in Rev. Rul. 77-347) that the receipt of state unemployment benefits is immaterial to the analysis by instead requiring a direct connection between SUB

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[12] As to the particular taxpayer before it, the Second Circuit held (consistent with the statutory definition) that the benefits in question were not SUB payments because they did not depend upon an "involuntary separation."

payments and the actual receipt of unemployment benefits. But if any ruling is entitled to deference, it would be Rev. Rul. 77-347. That contemporaneous ruling is the only one that actually analyzes, and conforms to, section 3402.

Of course, a revenue ruling is not entitled to the same deference as a statute or regulation, nor does it have the force of law. *Comm'r* v. *Schleier*, 515 U.S. 323, 336 n.8 (1995) ("[T]he Service's interpretive rulings do not have the force and effect of regulations." (quoting *Davis* v. *United States*, 495 U.S. 472, 484 (1990)) (internal quotation marks omitted)). Because the revenue rulings on which the government relies are not entitled to judicial deference under *Chevron U.S.A., Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), they only have authority to the extent they have "power to persuade" under *Skidmore* v. *Swift & Co.*, 323 U.S. 134, 140 (1944). As this Court has explained, the extent of *Skidmore* "deference" depends on several factors, including the thoroughness of the ruling, the quality of its reasoning, and its consistency with other pronouncements. *United States* v. *Mead Corp.*, 533 U.S. 218, 228 (2001). Of particular relevance, this Court has declined to give any special weight to rulings where, as here, they conflict with the agency's earlier pronouncements. See, e.g., *Gen. Elec. Co.* v. *Gilbert*, 429 U.S. 125, 143 (1976) (citing *United Housing Found., Inc.* v. *Forman*, 421 U.S. 837, 858 n.25 (1975)), *superseded on other grounds by* 92 Stat. 2076, 42 U.S.C. § 2000e(k).

The IRS's position in Rev. Rul. 90-72 (on which it heavily relies in this case) departs radically from its post-§ 3402(o) rulings—with no reasoning or rationale for doing so. What is more, Rev. Rul. 90-72 does not address, much less attempt to explain, the departure from, among other things, this Court's decisions in *Rowan* and *Coffy*, the Second Circuit's decision in *NYSA-ILA*, the Treasury Department's information-reporting regulations, and the Treasury Department's SUB payment regulations that do not require ongoing unemployment to receive benefits. Devoid of reasoning and inconsistent with the IRS's previous pronouncements, the revenue ruling is entitled to no deference whatsoever.

In addition, the revenue ruling fails the requirement imposed by this Court in *Central Illinois Public Service* v. *United States*, 435 U.S. 21, 31 (1978), that an "employer's [payroll] obligation to withhold be precise and not speculative." In this case, the IRS's unexplained departure from decades of consistent practice leaves employers and payroll administrators struggling to piece together (from inconsistent rulings dating back more than half a century) when a payment is a SUB payment for FICA purposes, and when it is not.

Indeed, the definition of SUB payments proposed by the IRS is so imprecise that the IRS and the Federal Circuit, in *CSX Corp.* v. *United States*, 518 F.3d 1328 (Fed. Cir. 2008) (holding against the taxpayer), could agree on only five factors in the IRS's

unwieldy eight-factor test—and the IRS has not explained or analyzed why each of those factors is even relevant to the analysis. Compare Rev. Rul. 56-249, with *CSX Corp.*, 518 F.3d at 1335.[13]

Thus, in addition to being inconsistent with Congress's clear, objective approach in defining SUB payments in the "interest of simplicity and ease of administration," *Rowan*, 452 U.S. at 255 (citation and internal quotation marks omitted), the IRS's piecemeal approach fails *Central Illinois*' requirement of precision and should be rejected for that reason, too.

## IV. The Government's Reliance On The 1983 "Decoupling Amendments" Is Misplaced

Much like the *Central Illinois* requirement, the *Rowan* principle that "Congress intended 'wages' to mean the same thing under FICA, FUTA, and income-tax withholding" for Subtitle C purposes, 452 U.S. at 255, is premised on "congressional concern for 'the interest of simplicity and ease of administration.'" *Rowan*, 452 U.S. at 255; *Central Illinois*, 435 U.S. at 27. Thus, as this Court explained in *Rowan*, "[c]ontradictory interpretations of substantially identical definitions do not serve that interest" and "[i]t would

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[13] The Federal Circuit created a six-factor test as it dropped three of the IRS's factors (2, 5, and 6) and added a new one (payment of "substitute benefit").

be extraordinary for a Congress pursuing this interest to intend, without ever saying so, for identical definitions to be interpreted differently." 452 U.S. at 257.

In 1983, Congress responded by providing the Treasury Department with the flexibility to make distinctions *in its regulations* when defining wage exclusions between the FICA and income-tax withholding provisions. Called the "decoupling" amendments, these provisions state that "[n]othing *in the regulations* prescribed for purposes of chapter 24 (relating to income-tax withholding) which provides an exclusion from 'wages' as used in such chapter shall be construed to require a similar exclusion from 'wages' *in the regulation prescribed* for purposes of this chapter." 26 U.S.C. §§ 3121(a) & 3306(b) (emphases added).

As is apparent on their face, however, the decoupling amendments are not self-effectuating but are contingent upon the issuance of regulations making distinctions between wage exclusions for FICA and FITW purposes. Here, no such regulations have been issued—and that is fatal to the government's attempt to rely upon the amendments to decouple the SUB payment definition for FICA and FITW purposes. As the court of appeals correctly explained, the Treasury Department has not issued regulations adopting the IRS's approach to SUB payment, Pet. App. 16a—and in the absence of such regulations, the decoupling amendments do not apply and *Rowan* requires instead that the definition of wages under

FICA be construed consistently with the definition of wages for income-tax withholding purposes. The government's reliance on the decoupling amendments is thus misplaced.

## V. Congressional Acquiescence Shows Approval Of The SUB Payment FICA Exclusion

For more than half a century, the government has consistently recognized that SUB payments are excluded from FICA wages. Now, for the first time to our knowledge, the government questions the validity of *all* of the IRS's SUB payment rulings—suggesting in a footnote that "it might reasonably have been disputed whether, as an original matter, the IRS was authorized to act as it did." Br. 30. As the government quickly points out, however, Congress has "effectively acquiesced in the IRS's approach." *Ibid.* Given the IRS's inconsistent rulings, however, the question is in which "approach" has Congress acquiesced?[14]

The government's own merits briefing displays the same inconsistency that has plagued the IRS's revenue rulings, as the government strongly defends those rulings on one page of its brief and then effectively denounces them on the next. Compare Br. 17-18, 29-30, and 32-34, with Br. 30 n.4. From a broader tax administration perspective, the inconsistency also underscores the serious ramifications that a ruling by

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[14] To be clear, our argument is that Congress has acquiesced in the exclusion, not in the definition of the exclusion offered by the government in this case.

this Court accepting the government's position could have—that is, if the definition of SUB payments can be based "solely" on revenue rulings that do not have the force of law, then what other areas of tax law can be changed on the agency's whim simply by issuing a revenue ruling and declaring the agency's preferred result by fiat?

The SUB payment exemption from FICA taxes has been recognized by Treasury regulations and every court to examine the issue—including the Federal Circuit in *CSX Corp.* Where, as here, "Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes," they are "deemed to have received congressional approval and have the effect of law." *United States* v. *Cleveland Indians Baseball Co.*, 532 U.S. 200, 220 (2001) (quoting *Cottage Sav. Ass'n* v. *Comm'r*, 499 U.S. 554, 561 (1991) (quoting *United States* v. *Correll*, 389 U.S. 299, 305-06 (1967))) (internal quotation marks omitted). Thus "whether or not Congress can be said to have 'acquiesced' in the administrative practice, it certainly has not acted to change it * * * * In light of these substantial reliance interests, the longstanding administrative construction of the statute should 'not be disturbed except for cogent reasons.'" *Zenith Radio Corp.* v. *United States*, 437 U.S. 443, 457-58 (1978)

(quoting *McLaren* v. *Fleischer*, 256 U.S. 477, 481 (1921)).[15]

Here, Congress has not merely acquiesced in SUB payments being excluded from Subtitle C "wages" for more than 50 years, but also has affirmatively acted to create a statutory framework that supports, complements, and defines that exclusion as identified in the IRS's own rulings. For example:

- The legislative history of § 501(c)(17) references the IRS's SUB payments rulings, S. Rep. 86-1518, *reprinted in* 1960 U.S.C.C.A.N. at 3204;
- The legislative history of § 3402(o) specifically acknowledges that "present law" excludes SUB payments from "wages," S. Rep. 91-552, *reprinted in* 1969 U.S.C.C.A.N. at 2305;
- The FUTA provisions of Subtitle C connect SUB payments, as defined by Congress, with state legislatures for funding

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[15] "Although the Service's interpretive rulings do not have the force and effect of regulations, see *Bartels* v. *Birmingham*, 332 U.S. 126, 132 (1947), we give an agency's interpretations and practices considerable weight where they involve the *contemporaneous construction* of a statute and where they have been in *long use*." *Davis* v. *United States*, 495 U.S. 472, 484 (1990) (emphases added) (citing, for example, *Norwegian Nitrogen Prods. Co.* v. *United States*, 288 U.S. 294, 315 (1933)). Unlike Rev. Rul. 90-72, Rev. Rul. 77-347 was contemporaneously constructed and used for a substantial time without challenge.

and computing extended unemployment benefits, see *supra* 23 n.11; and

- Section 419A acknowledges a distinction between SUB payments and severance, 26 U.S.C. § 419A(f)(1).

These data points demonstrate Congress's awareness and understanding of SUB payments—including the treatment of SUB payments as excluded from "wages" for Subtitle C purposes (i.e., FICA, FUTA, and FITW). And that understanding has a long pedigree. For example, section 3402(o), which acknowledged that SUB payments were excluded from wages under "present law," has remained unchanged for more than 40 years—even as the FITW provisions themselves have been amended at least 13 times. Similarly, the interplay between FUTA-FSEUCA and SUB payments as defined by Congress has not changed once in its more than 30-year existence—even though the FUTA definitional provisions have been amended more than 20 times. And the definition of SUB payments set forth in § 501(c)(17) has remained unchanged for more than half a century. The FICA SUB payment exclusion should therefore be "deemed to have received congressional approval and have the effect of law." *Cleveland Indians*, 532 U.S. at 220.

At the same time that Congress has "effectively acquiesced" in the SUB payment FICA exclusion at issue here, Congress has had multiple opportunities to adopt the definition of SUB payments urged in IRS revenue rulings and before this Court, but has not

done so. Instead, Congress restated its definition of SUB payments when it enacted § 3402(o)—and as set out above, it has referenced that same definition on other occasions since then.

* * *

In marked contrast to the continuity, consistency, and administrability of the statutory definition of SUB payments, the definition urged by the government has been cobbled together from several revenue rulings that are themselves inconsistent with the IRS's own rulings issued contemporaneously with § 3402. Furthermore, that definition is itself subject to change in order to accommodate "possible refinements in IRS practice," as the government puts it. Br. 34. But the evolving definition offered by the government has never been authorized by Congress. It has not been promulgated in regulations by the Treasury Department. And it reflects an abrupt and radical change in the IRS's own longstanding position. This Court should therefore decline the government's invitation to cast aside the well-established statutory definition of SUB payments that, unlike the government's definition, furthers the congressional purpose of simplicity and ease of administration highlighted by this Court in *Rowan*.

## CONCLUSION

The judgment of the court of appeals should be affirmed.

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# AMICUS CURIAE BRIEF

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No. 12-1408

IN THE
# Supreme Court of the United States

UNITED STATES OF AMERICA,
*Petitioner*,

v.

QUALITY STORES, INC., ET AL.,
*Respondents*.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS FOR THE
SIXTH CIRCUIT

## BRIEF OF THE ERISA INDUSTRY COMMITTEE AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS QUALITY STORES, INC., ET AL. AND AFFIRMANCE

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## TABLE OF CONTENTS


Page

TABLE OF CONTENTS ..... i

TABLE OF AUTHORITIES ..... iii

INTEREST OF AMICUS CURIAE ..... 1

INTRODUCTION AND SUMMARY OF ARGUMENT ..... 3

ARGUMENT ..... 8

I. The Relevant Statutory Text Provides That SUB Payments Are Not Subject To FICA Taxes. ..... 8

A. FICA Taxes And Income Taxes ..... 8

B. SUB Payments Are Not Wages ..... 10

1. Several Statutory Provisions Are Relevant To Determining Whether SUB Payments Are "Wages" For FICA. ..... 10

2. The Text Of 26 U.S.C. §§ 3401 And 3402(o)(2)(A) Demonstrates That SUB Payments Are Not Wages ..... 13

3. Legislative History Confirms That SUB Payments Are Not Wages ..... 15

4. The Doctrine of Legislative Reenactment Demonstrates That SUB Payments Are Not Wages.....17

II. The Government's Contrary Arguments Are Unpersuasive And Incorrect.....20

A. The Government's Textual Argument Proves Too Much And Relies On The Very Interpretive Approach That The Government Elsewhere Rejects.....20

B. *Rowan* Continues To Require That "Wages" Be Interpreted Consistently For Income-Tax Withholding And FICA.....23

C. The Government's Attempt To Characterize The SUB Payments At Issue As Particularly Likely To Be Deemed "Wages" Lacks Merit.....25

D. The Government Attempts To Rewrite § 3402(o) To Support Its Position.....27

III. Policy Considerations Support The Conclusion That SUB Payments Are Not Subject To FICA Taxes.....28

CONCLUSION.....34

## TABLE OF AUTHORITIES

**Page(s)**

**Cases**

*Beck v. PACE Int'l Union*,
551 U.S. 96 (2007) ..... 1
*Black & Decker Disability Plan v. Nord*,
538 U.S. 822 (2003) ..... 1
*Cent. Ill. Pub. Serv. Co. v. United States*,
435 U.S. 21 (1978) ..... 8
*Coffy v. Republic Steel Corp.*,
447 U.S. 191 (1980) ..... 4, 13
*Comm'r v. Lundy*,
516 U.S. 235 (1996) ..... 12
*Conkright v. Frommert*,
130 S. Ct. 1640 (2010) ..... 1
*Conn. Nat'l Bank v. Germain*,
503 U.S. 249 (1992) ..... 28
*CSX Corp. v. United States*,
518 F.3d 1328 (Fed. Cir. 2008)..... 23
*Estate of Cowart v. Nicklos Drilling Co.*,
505 U.S. 469 (1992) ..... 11
*Firestone Tire & Rubber Co. v. Bruch*,
489 U.S. 101 (1989) ..... 1
*Gen. Dynamics Land Sys., Inc. v. Cline*,
540 U.S. 581 (2004) ..... 1
*Gustafson v. Alloyd Co., Inc.*,
513 U.S. 561 (1995) ..... 12
*Helvering v. R.J. Reynolds Tobacco Co.*,
306 U.S. 110 (1939) ..... 17, 18
*Hughes Aircraft Co. v. Jacobson*,
525 U.S. 432 (1999) ..... 1

*INS v. Nat'l Ctr. for Immigrants' Rights*,
502 U.S. 183 (1991) ..... 15
*LaRue v. DeWolff, Boberg & Assocs.*,
552 U.S. 248 (2008) ..... 1
*Lockheed Corp. v. Spink*,
517 U.S. 882 (1996) ..... 1
*Lorillard v. Pons*,
434 U.S. 575 (1978) ..... 17
*Mayo Found. for Med. Educ. & Research v. United States*,
131 S. Ct. 704 (2011) ..... 25
*Metro. Life Ins. Co. v. Taylor*,
481 U.S. 58 (1987) ..... 1
*Otte v. United States*,
419 U.S. 43 (1974) ..... 25
*Powerex Corp. v. Reliant Energy Servs., Inc.*,
551 U.S. 224 (2007) ..... 12
*Rudolph v. United States*,
370 U.S. 269, 274 n.7 (1962) ..... 19
*Rowan Cos., Inc. v. United States*,
452 U.S. 247 (1981) ..... *passim*
*Russello v. United States*,
464 U.S. 16 (1983) ..... 27
*Soc. Sec. Bd. v. Nierotko*,
327 U.S. 358 (1946) ..... 25
*United States v. Wong Kim Bo*,
472 F.2d 720 (5th Cir. 1972) ..... 28

**Statutes**

26 U.S.C. § 1 ..... 9
26 U.S.C. § 61 ..... 9
26 U.S.C. § 63 ..... 9
26 U.S.C. § 501(c)(17) ..... 6, 22, 32
26 U.S.C. § 3101 ..... 8

26 U.S.C. § 3121(a) ..... 4, 8, 9, 11, 13, 21
26 U.S.C. § 3401 ..... 4, 5, 12, 13, 17, 18
26 U.S.C. § 3401(a) ..... *passim*
26 U.S.C. § 3402(o) ..... *passim*
26 U.S.C. § 3402(o)(2)(A) ..... *passim*
ARIZ. ADMIN. CODE § R6-3-1705(E)(6) (2012) ..... 32
ARIZ. ADMIN. CODE § R6-3-1705(F) (2012) ..... 32
OKLA. ST. ANN. tit. 40, § 1-225(C)(1)–(3) (West 2013) ..... 32
WASH. REV. CODE ANN. §§ 50.20.120-.1201 (LexisNexis 2013) ..... 27

**Internal Revenue Service Revenue Rulings**

Rev. Rul. 56-249, 1956-1 C.B. 488 .... 19, 21, 22, 26, 31
Rev. Rul. 58-128, 1958-1 C.B. 89 ..... 32
Rev. Rul. 60-330, 1960-2 C.B. 46 ..... 32
Rev. Rul. 77-347, 1977-2 C.B. 362 ..... 5, 18, 19
Rev. Rul. 90-72, 1990-2 C.B. 211 ..... *passim*

**Other Authorities**

H.R. REP. NO. 86-1145 (1959) ..... 19
Oxford English Dictionary ..... 15
S. REP. NO. 91-552 (1969) ..... 5, 9, 16, 18
NORMAN J. SINGER & J.D. SHAMBIE SINGER, STATUTES AND STATUTORY CONSTRUCTION § 46:6 (7th ed. 2007) ..... 28
Supreme Court Rule 37.6 ..... 1

## INTEREST OF AMICUS CURIAE

The ERISA Industry Committee ("ERIC") is a nonprofit organization representing America's largest private employers sponsoring pension, savings, healthcare, disability, and other employee benefit plans that provide benefits to millions of active workers, retired persons, and their families nationwide.[1] ERIC frequently participates as *amicus curiae* in cases before this Court that have the potential for far-reaching effects on employee benefit design or administration.[2] All of ERIC's members do business in more than one State, and many have employees in all fifty States.

As employers, ERIC's members benefit from clarity in the administration of federal employment taxes under the Federal Insurance Contributions Act ("FICA"). By looking to the statutory definition of "supplemental unemployment compensation

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[1] Pursuant to Supreme Court Rule 37.6, the *amicus* affirms that no counsel for a party authored this brief in whole or in part, that no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief, and that no person other than the *amicus* or its counsel made such a monetary contribution. All parties have consented to the filing of this brief in letters filed with the Clerk of this Court.

[2] *See, e.g., Conkright v. Frommert*, 130 S. Ct. 1640 (2010); *LaRue v. DeWolff, Boberg & Assocs.*, 552 U.S. 248 (2008); *Beck v. PACE Int'l Union*, 551 U.S. 96 (2007); *Gen. Dynamics Land Sys., Inc. v. Cline*, 540 U.S. 581 (2004); *Black & Decker Disability Plan v. Nord*, 538 U.S. 822 (2003); *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432 (1999); *Lockheed Corp. v. Spink*, 517 U.S. 882 (1996); *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101 (1989); *Metro. Life Ins. Co. v. Taylor*, 481 U.S. 58 (1987).

benefits" ("SUB payments") in 26 U.S.C. § 3402(o)(2)(A) to determine the type of employer-provided unemployment benefits that are excluded from the definition of wages for purposes of FICA taxes, the Sixth Circuit has provided a clear, uniform rule that treats all similarly situated employers and employees throughout the country the same and does not turn on the vagaries of state law. By contrast, a rule that makes the classification of employer-provided unemployment benefits for FICA purposes turn on eligibility for state unemployment benefits, as the government contends, requires employers to consider the unemployment benefit requirements of up to fifty states (as well as the District of Columbia and Puerto Rico) in order to determine the FICA tax treatment for employees. Reliance on the statutory definition in 26 U.S.C. § 3402(o)(2)(A) fosters uniform administration of SUB plans and reduces the cost of providing such benefits to employees.

In addition, many of ERIC's members have filed refund claims to recover FICA taxes on benefits paid to former employees under SUB plans. The decision in this case likely will influence the outcome of the members' refund claims and determine whether affected individuals in similar circumstances are treated the same throughout the country.

Because employers' FICA tax refund claims provide an opportunity for employees to recover the employees' share of the FICA taxes, former employees will also benefit if the refund claims are granted. Refunds recovered by employers and by former employees may provide a source of economic

relief for companies and individuals in today's challenging economic environment, which in many cases has led to downsizing and layoffs triggering the need for the payments at issue in this case.

## INTRODUCTION AND SUMMARY OF ARGUMENT

When Respondent Quality Stores, Inc. ("Quality Stores") closed its stores, it paid supplemental unemployment compensation benefits to certain employees who were laid off. Both Quality Stores and the employees paid FICA taxes on these SUB payments. Quality Stores argues that the SUB payments are not "wages" under applicable statutory provisions, and therefore are not subject to FICA taxes.

The government recognizes that some SUB payments are not wages for FICA purposes. The parties disagree over which SUB payments are excluded from the definition of wages. Quality Stores argues that payments meeting the definition of SUB payments in the Internal Revenue Code ("I.R.C.") are not wages for FICA purposes. The government argues that, to qualify as non-wages, SUB payments must meet not only the statutory definition of a SUB payment but also criteria set out in Internal Revenue Service ("IRS") Revenue Rulings that have changed over time.

Both the statutory text and the legislative history support the conclusion that SUB payments, as defined in the I.R.C., are not "wages." The government's arguments to the contrary are internally inconsistent and at odds with this Court's

precedents. In addition, the government's approach produces to a cumbersome system in which the classification of SUB payments for FICA purposes turns on a recipient's eligibility for state unemployment benefits.

1. The definition of wages in the FICA chapter of the I.R.C., 26 U.S.C. § 3121(a), does not explicitly address SUB payments. The wage provisions in the income-tax withholding chapter *do* specifically address SUB payments, and make clear that such payments are not "wages." *See* 26 U.S.C. §§ 3401(a), 3402(o)(2)(A). This Court has concluded that the definitions of "wages" in the FICA chapter and in the income-tax withholding chapter are "substantially identical," and that Congress "intended its definition [of 'wages'] to be interpreted in the same manner for FICA . . . as for income tax withholding." *Rowan Cos., Inc. v. United States*, 452 U.S. 247, 249, 263 (1981).

The text of 26 U.S.C. §§ 3401 and 3402(o)(2)(A) points to the conclusion that SUB payments are not "wages." *First*, SUB payments are not "remuneration . . . for services." 26 U.S.C. § 3401(a). Because SUB payments are "contingent on the employee's being thrown out of work," *Coffy v. Republic Steel Corp.*, 447 U.S. 191, 200 (1980), they are not compensation for services. *Second*, § 3402(o) extends employers' obligation to withhold income tax to "certain payments *other than wages*," 26 U.S.C. § 3402(o), and lists SUB payments among the payments subject to this treatment. Moreover, § 3402(o)(1)(A) specifically provides that SUB payments "shall be treated *as if*" they are wages.

This statutory language clearly indicates that SUB payments are *not* wages.

The legislative history strongly confirms that SUB payments are not wages. The Senate Report that accompanies § 3402(o) states *three times* that SUB payments are not wages, and also states that they are not "remuneration for services." S. REP. NO. 91-552, at 268 (1969).

Moreover, when Congress adopted the current versions of §§ 3121, 3401, and 3402 in 1986, it was aware that the IRS treated all SUB payments as non-wages. *See* Rev. Rul. 77-347, 1977-2 C.B. 362. Under the doctrine of legislative reenactment, Congress is presumed to have approved the existing IRS practice, and therefore the IRS cannot now interpret "wages" for FICA tax purposes in a manner inconsistent with the reenacted statutes.

2. The government's contrary arguments are unpersuasive.

The government's arguments are internally inconsistent. The government argues that SUB payments are "wages" for FICA purposes unless there is an explicit statutory exemption. That argument is inconsistent with current IRS practice, which deems certain SUB payments to be non-wages for FICA purposes even though there is no express statutory exemption. *See* Rev. Rul. 90-72, 1990-2 C.B. 211. In addition, the government suggests that the IRS may have lacked statutory authority to exempt some SUB payments from "wages," but it continues to rely on the same Revenue Rulings it suggests may have been invalid. Finally, to overcome what it views as the potential invalidity of

the IRS exclusion of some SUB payments from "wages," the government argues that Congress acquiesced to the IRS position in two statutory provisions located outside the FICA chapter. By relying on provisions from the income tax (26 U.S.C. § 501(c)(17)) and income-tax withholding (§ 3402(o)) chapters of the I.R.C. to support its interpretation of "wages" under FICA, the government engages in the very interpretive method that it contends is impermissible for Quality Stores.

The government's position is also at odds with *Rowan*'s instruction that the definitions of "wages" for FICA and income-tax withholding must be interpreted consistently. Contrary to the government's claim, the interest in "simplicity and ease of administration" is a reason to reject the government's position, which creates complications due to varying treatment of SUB payments depending on state unemployment benefits.

The government asserts that the SUB payments at issue here are especially appropriate for "wage" treatment because they were paid to former employees and the payments depended in part on the length of time recipients worked and their salaries. But SUB payments, by definition, are paid to former employees, and the IRS has long approved non-wage treatment for payments that are linked to recipients' status within the former employer. Under the statutory definition, factors such as whether SUB payments are linked to seniority with the former employer are not relevant to whether the payments are wages.

Finally, the government attempts to rewrite § 3402(o) to support its position by describing the

statute as requiring that SUB payments "will be subject to income-tax withholding *whether or not* they would otherwise be 'wages.'" U.S. Br. at 28. But § 3402 contains no such limitation.

3. Policy considerations provide additional support for the conclusion that SUB payments are not wages for FICA tax purposes.

The government's position makes the status of SUB payments turn on whether the payments are "linked to state unemployment compensation" pursuant to Rev. Rul. 90-72. This results in a cumbersome system in which the federal tax status of SUB payments depends on the state of residence of recipients.

The government's position also imposes an undue hardship on the very recipients that SUB payments are designed to help. Under the government's approach, either: (i) an individual qualifies for state unemployment benefits and therefore can benefit from non-wage treatment of SUB payments under FICA, or (ii) an individual is not eligible for state unemployment benefits, and therefore must pay FICA taxes on SUB payments. The government's approach disadvantages recipients who must rely exclusively on SUB payments. There is no evidence that Congress intended to afford different federal tax treatment to companies and individuals based on their state of residence. Moreover, the government would prohibit non-wage treatment for SUB payments paid in a lump sum. This limitation imposes a hardship on individual recipients who rely on a lump sum SUB payment as a crucial supplement to state benefits to mitigate the costs occasioned by sudden loss of employment.

## ARGUMENT

### I. The Relevant Statutory Text Provides That SUB Payments Are Not Subject To FICA Taxes.

#### A. FICA Taxes And Income Taxes

As this Court has explained, "'wages' is a narrower concept than 'income.'" *Rowan*, 452 U.S. at 254. "'Wages usually are income, but many items qualify as income and yet clearly are not wages.'" *Id.* (quoting *Cent. Ill. Pub. Serv. Co. v. United States*, 435 U.S. 21, 25 (1978)). "Wages" generally are subject to both income taxes and FICA taxes, which fund Social Security and Medicare.

The parties agree that the SUB payments Quality Stores paid to employees who were laid off are income to the employees. They disagree, however, over whether the SUB payments are, or are not, "wages." If the SUB payments are "wages," then they are subject to FICA taxes, which are paid by both the employer and the employees. If they are not "wages," then Quality Stores and its former employees were not required to pay FICA taxes on the SUB payments.

FICA and income taxes are addressed in separate chapters of the I.R.C. The I.R.C. specifies that "wages" are subject to FICA taxes, 26 U.S.C. § 3101, and defines wages as "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash," with the exception of particular exclusions not relevant here, *id.* § 3121(a).

The income tax chapter of the Code imposes income-tax withholding on "wages," *id.* § 3402(a)(1), defined as "all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any other medium other than cash," with the exception of exclusions not relevant here, *id.* § 3401(a). This Court has explained that the definitions of "wages" in § 3121(a) and § 3401(a) are "substantially identical." *Rowan*, 452 U.S. at 249.

Unlike FICA taxes, which apply only to wages, income taxes apply to both wage and non-wage income. *See* 26 U.S.C. §§ 1, 61, 63. As a result, even if income-tax withholding and FICA taxes do not apply to a payment, the payment may still be subject to income tax. Thus, payments by an employer to an employee that are not "wages" as defined in § 3121(a) or § 3401(a) may be subject to income tax even though they are not subject to income-tax withholding or to FICA taxes.

In the absence of income-tax withholding, these non-wage payments might lead to burdensome tax payments for taxpayers at the time their income tax returns are filed because taxes already withheld would not cover their final income tax liability. S. REP. NO. 91-552, at 268-69. To address this concern, the I.R.C. imposes income-tax withholding on certain payments that would otherwise *not* be subject to withholding because they are not wages. 26 U.S.C. § 3402(o); *id.* § 3402(o)(1)(A) (imposing income-tax withholding on "any supplemental

unemployment compensation benefit paid to an individual").

### B. SUB Payments Are Not Wages.

Section 3402(o)(2)(A) defines "supplemental unemployment compensation benefits" or "SUB payments" as:

> amounts which are paid to an employee, pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment (whether or not such separation is temporary), resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, but only to the extent such benefits are includible in the employee's gross income.

*Id.* § 3402(o)(2)(A). The parties have stipulated that "[a]ll payments Quality Stores made to its former employees . . . satisfy this five-part statutory test to qualify as SUB payments." Pet. App. 11.

#### 1. Several Statutory Provisions Are Relevant To Determining Whether SUB Payments Are "Wages" For FICA.

Quality Stores argues that *no* SUB payments are wages, Resp. Br. at 17-19, while the United States recognizes that *some* SUB payments are not wages, U.S. Br. at 28. The parties disagree over which statutory provisions are relevant to determining whether SUB payments are wages.

In any statutory construction case, the analysis begins with the statutory text. *Estate of Cowart v. Nicklos Drilling Co.*, 505 U.S. 469, 475 (1992). A prior question, however, is which statutory text is relevant.

The government focuses its attention on the FICA chapter of the I.R.C., with the definition of wages in § 3121(a). U.S. Br. at 10. Although it makes sense to begin the analysis by looking to the FICA chapter to assess whether SUB payments are "wages" for FICA purposes, a review of the FICA chapter quickly reveals that it does not explicitly address how SUB payments should be treated. That does not end the inquiry, however, because SUB payments *are* explicitly addressed in a parallel income-tax withholding provision, which this Court has looked to in the past to construe "wages."

This Court has held that "wages" in § 3121(a) must be construed consistently with the definition of "wages" in § 3401(a), which defines wages for purposes of income-tax withholding. In *Rowan Cos. v. United States*, 452 U.S. 247, this Court considered the precise issue of whether the word "wages" has the same meaning in 26 U.S.C. § 3401(a) (income-tax withholding) and § 3121(a) (FICA). Applying principles of statutory construction, the Court concluded that "wages" should be interpreted consistently across the two sections. *Id.* at 263. The Court observed that the definitions of "wages" in § 3401(a) and § 3121(a) are "substantially identical" and held that "[t]he plain language and legislative histories of the relevant Acts indicate that Congress intended its definition [of 'wages'] to be interpreted

in the same manner for FICA . . . as for income tax withholding." *Id.* at 249, 263. Accordingly, the Court treated non-wage payments for income-tax withholding purposes as non-wage payments for FICA tax purposes.

The Court's holding in *Rowan* is consistent with the "standard principle of statutory construction . . . that identical words and phrases within the same statute should normally be given the same meaning." *Powerex Corp. v. Reliant Energy Servs., Inc.*, 551 U.S. 224, 232 (2007); *Comm'r v. Lundy*, 516 U.S. 235, 250 (1996); *Gustafson v. Alloyd Co., Inc.*, 513 U.S. 561, 568 (1995) (noting that the principle that a "term should be construed, if possible, to give it a consistent meaning throughout the Act . . . follows from [the Court's] duty to construe statutes, not isolated provisions").

In short, Congress did not specifically address SUB payments in the FICA chapter, but it *did* explicitly address them in the income-tax withholding chapter, which, as the next Section explains, makes clear that SUB payments are non-wages. Per this Court's instruction in *Rowan* that the definition of "wages" should be interpreted consistently across the income-tax withholding and FICA chapters, § 3401 and § 3402(o) make clear that SUB payments are not "wages" and therefore are not subject to FICA taxes.

### 2. The Text Of 26 U.S.C. §§ 3401 And 3402(o)(2)(A) Demonstrates That SUB Payments Are Not Wages.

The relevant statutory text is clear that SUB payments are not "wages" and therefore are not subject to FICA taxes.

*First*, SUB payments are not wages because they are not "remuneration . . . for services" as required by the definition of wages in § 3401(a). As noted above, § 3401(a) defines "wages" as "all remuneration . . . for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash." SUB payments are "remuneration," U.S. Br. at 10-11, but they are not "remuneration . . . *for services*," 26 U.S.C. § 3401(a) (emphasis added). In *Coffy v. Republic Steel Corp.*, this Court explained, "SUBs cannot be compensation for work performed, . . . for they are contingent on the employee's being thrown out of work; unless the employee is laid off he will never receive SUB payments." 447 U.S. at 200. In other words, it is precisely because the employee is not performing services that he or she is eligible to receive SUB payments. Therefore, SUB payments are not "remuneration . . . *for services performed*" and consequently do not meet the definition of "wages" in § 3401(a). 26 U.S.C. § 3401(a) (emphasis added); *see also id.* § 3121(a) (defining "wages" as "all remuneration *for employment*" (emphasis added)).

*Second*, the text of § 3402 makes clear that SUB payments are not wages. As explained above, employers who pay "wages" are required to withhold

income taxes with respect to those "wages." *Id.* § 3402(a). However, § 3402(o) extends employers' obligation to withhold income tax "to certain payments *other than wages*." *Id.* § 3402(o) (emphasis added). The list of payments "other than wages" includes SUB payments. Section 3402(o)(1)(A) specifically provides that "any supplemental unemployment compensation benefit paid to an individual . . . shall be treated *as if* it were a payment of wages." *Id.* § 3402(o)(1)(A) (emphasis added). Moreover, Congress's list of payments other than wages in § 3402(o) includes three items: (1) "any supplemental unemployment compensation benefit paid to an individual," (2) "any payment of an annuity to an individual," and (3) "any payment to an individual of sick pay *which does not constitute wages*." *Id.* § 3402(o)(1)(A)-(C) (emphasis added). Congress used language indicating that sick pay may or may not constitute wages; it did not use this language for supplemental employment compensation benefits (or annuities), indicating that all such payments are non-wages. *See* Resp. Br. at 22-23.

The clear implication of this statutory language is that SUB payments are not "wages" and that, but for the express rule of § 3402(o)(1)(A) instructing that they be treated "as if" they were wages, no income-tax withholding would be required with respect to such payments. By treating SUB payments "as if" they are "wages" and thereby requiring income-tax withholding, Congress assisted taxpayers in avoiding burdensome tax bills when they file their returns because the income-tax withholding would otherwise be insufficient.

If there were any remaining ambiguity, the title of § 3402(o) confirms that SUB payments are not wages. *See INS v. Nat'l Ctr. for Immigrants' Rights*, 502 U.S. 183, 189 (1991) ("[T]he title of a statute or section can aid in resolving an ambiguity in the legislation's text."). Section 3402(o) is entitled "[e]xtension of withholding to certain payments *other than wages*." 26 U.S.C. § 3402(o) (emphasis added). Thus, the SUB payments addressed in that section are "other than wages," which is to say *not wages*. *See* Oxford English Dictionary, http://www.oed.com/view/Entry/133219?rskey=G2eR0K&result=1&isAdvanced=false#eid33046221 (Dec. 11, 2013) (definition 5(e), defining "other than" as "besides, except, apart from").

### 3. Legislative History Confirms That SUB Payments Are Not Wages.

The legislative history of § 3402(o)(2)(A) also supports the conclusion that SUB payments are not wages. The Senate Report on § 3402(o) at the time of its enactment categorically and repeatedly states that SUB payments are not wages. In relevant part, the Report explains:

> *Present law.*—Under present law, supplemental unemployment benefits are not subject to withholding because they do not constitute wages or remuneration for services.
>
> *General reasons for change.*—Supplemental unemployment compensation benefits (SUB) paid by

> employers are generally taxable income to the recipient. Consequently, the absence of withholding on these benefits may require a significant final tax payment by the taxpayer receiving them. The committee concluded that although these benefits are not wages, since they are generally taxable payments they should be subject to withholding to avoid the final tax payment problem for employees.
>
> *Explanation of provision.*—The committee amendments require the payor of taxable supplemental compensation unemployment benefits to withhold Federal income tax from these payments. The withholding requirements applicable to withholding on wages are to apply to these nonwage payments.

S. REP. NO. 91-552, at 268 (underlining added, italics in the original). In these few paragraphs, the Report states not once but *three* times that SUB payments "do not constitute wages," "are not wages," and are "nonwage payments." *Id.* Moreover, the Report explicitly states that SUB payments "do not constitute remuneration for services," which is a necessary element for SUB payments to constitute "wages" under the statute. Congress was clear both that SUB payments do not meet the "remuneration for services" criterion for constituting wages and, in case any ambiguity remained, that SUB payments

simply do not constitute wages for purposes of income-tax withholding under § 3401.

### 4. The Doctrine of Legislative Reenactment Demonstrates That SUB Payments Are Not Wages.

The doctrine of legislative reenactment provides that when "Congress adopts a new law incorporating sections of a prior law, Congress normally can be presumed to have had knowledge of the interpretation given to the incorporated law, at least insofar as it affects the new statute." *Lorillard v. Pons*, 434 U.S. 575, 581 (1978). Pursuant to this doctrine, Congress's reenactment of existing legislation is presumed to incorporate administrative practice and interpretations of the existing legislation prior to the reenactment. In other words, if Congress reenacts a statutory provision without explicitly modifying it to conflict with an agency's preexisting practice, Congress is deemed to have "approved the administrative construction and thereby to have given it the force of law." *Helvering v. R.J. Reynolds Tobacco Co.*, 306 U.S. 110, 115 (1939). In such a circumstance, the agency is not permitted to change its interpretation of the reenacted provision in a manner inconsistent with the understanding that Congress had when it reenacted the statute.

Congress reenacted the statutory provisions at issue in this case against a backdrop in which the IRS considered SUB payments to be non-wages. The IRS therefore cannot now alter its interpretation of the statutory provisions to render SUB payments "wages" for FICA purposes.

The current versions of §§ 3121, 3401, and 3402 all were adopted as part of the Internal Revenue Code of 1986. By 1986, the IRS treated all payments that met the definition of SUB payments in § 3402(o)(2)(A) as non-wages for purposes of FICA taxes. *See* Rev. Rul. 77-347, 1977-2 C.B. 362. In Rev. Rul. 77-347, the IRS, relying on the statutory definition, explicitly recognized that whether SUB payments are "tied to [a] State's unemployment benefits is not a material or controlling factor" for non-wage treatment for both FICA and income-tax withholding purposes. *Id.*

Congress was aware of the IRS's practice of treating SUB payments as non-wages and specifically recognized that statutorily defined SUB payments are not wages. *See* S. REP. NO. 91-552, at 286; *see supra* pp. 15-17. Congress's actual awareness of the IRS practice more than satisfies the requirements for legislative reenactment, which usually rests on a mere *presumption* that Congress was aware of preexisting practice. *See R.J. Reynolds Tobacco Co.*, 306 U.S. at 115 (holding that, by virtue of legislative reenactment, Congress was presumed to have approved IRS administrative practice restricting the statutory definition of "gross income" in subsequent reenactments of the I.R.C.).

In other contexts, both Congress and this Court have recognized that the IRS has treated SUB payments as non-wages. When Congress first enacted the current statutory definition of "supplemental unemployment compensation benefits" in the context of extending tax-exempt status to trusts established to provide such benefits,

Congress acknowledged that IRS rulings held that SUB payments were not subject to income-tax withholding. H.R. REP. NO. 86-1145, at 4 (1959) ("Various rulings of the Internal Revenue Service have held that the contributions to these funds are deductible to the employers and distributions from these funds are taxable to the recipients as income (although not generally subject to withholding)."). Similarly, in *Rudolph v. United States*, this Court acknowledged that "supplemental unemployment benefit" payments are excluded from wages. 370 U.S. 269, 274 n.7 (1962) ("[P]ayments to laid-off employees from company-financed supplemental unemployment benefit plans are 'taxable income' to the employees although not 'wages' subject to withholding." (citing Rev. Rul. 56-249, 1956-1 C.B. 488)).

In sum, when it reenacted the relevant provisions of the I.R.C. in 1986, Congress is presumed to have been aware—and, in fact, was aware—that the IRS treated all SUB payments as non-wages, and Congress is presumed to have incorporated the non-wage treatment into the I.R.C. as of 1986. At the time Congress reenacted the relevant statutory provisions, the IRS's practice of treating SUB payments as non-wages was clearly set out in Rev. Rul. 77-347, 1977-2 C.B. 362, which applied the § 3402(o)(2)(A) definition of SUB payments to identify employer-provided unemployment benefits that were not wages for purposes of FICA taxes and also recognized that ties to state unemployment benefits were "immaterial" for non-wage treatment. Accordingly, under the legislative reenactment doctrine, the IRS is not free

to interpret the term "wages" for FICA tax purposes inconsistently with the reenacted statutes. The government's position that the SUB payments at issue in this case are "wages" for FICA tax purposes is inconsistent with the position the IRS held at the time the relevant provisions of the I.R.C. were reenacted in 1986, and it is therefore impermissible.

## II. The Government's Contrary Arguments Are Unpersuasive And Incorrect.

### A. The Government's Textual Argument Proves Too Much And Relies On The Very Interpretive Approach That The Government Elsewhere Rejects.

The United States argues that "[p]ayments that meet the basic statutory definition of 'wages' are covered by FICA 'unless specifically excepted,'" U.S. Br. at 13 (quoting 26 C.F.R. §§ 31.3121(a)-1(b)), and that "Respondents have not contended, and the court of appeals did not hold, that the severance payments at issue here fit within any of those exceptions," *id.* at 14. The government's argument suffers from several problems.

*First*, the government's position is internally inconsistent. The government's insistence that SUB payments are "wages" for FICA purposes unless there is an explicit exemption for such payments, *id.* at 13-14, is inconsistent with the government's own treatment of SUB payments under FICA. The government makes arguments based on Rev. Rul. 90-72, *id.* at 8, 17-18, but does not acknowledge that that Ruling deems certain SUB payments to be non-wages for FICA purposes *notwithstanding the lack of*

*an express statutory exemption*. Rev. Rul. 90-72, 1990-2 C.B. 211 (determining that SUB payments that are linked to state unemployment compensation and received over time (*i.e.*, not in a lump sum) are "not wages for purpose of the FICA . . . taxes").

Similarly, the government's insistence on an explicit exemption for SUB payments in the FICA chapter is inconsistent with its concession that *some* SUB payments are not wages for income-tax withholding purposes. U.S. Br. at 28. Like the FICA chapter, the income-tax withholding chapter does not include a statutory exemption from the definition of "wages" for SUB payments. *See* 26 U.S.C. § 3401(a). By insisting in its brief on an explicit statutory exemption in the FICA chapter while conceding that some SUB payments are not wages for income-tax withholding even absent a statutory exemption, the government treats the definitions of "wages" in § 3401(a) and § 3121(a) differently, despite this Court's admonition in *Rowan* that Congress intended the provisions "to be interpreted in the same manner." *Rowan*, 452 U.S. at 263.

*Second*, the government's argument that (at least with respect to FICA) SUB payments are wages unless there is an explicit textual exemption implies that the IRS may have lacked authority to exempt SUB payments from "wages" in its 1956 Rev. Rul. 56-249. U.S. Br. at 30 ("The IRS did not identify any explicit textual basis for concluding that these types of payments were not 'wages' under the applicable statutory definitions. Given the broad and facially unqualified wording of these definitions . . . , it might reasonably have been disputed whether, as an

original matter, the IRS was authorized to act as it did."). In other words, the government's argument proves too much because it suggests that the United States lacks authority to treat *any* SUB payments as non-wages—despite the fact that the United States has exercised this authority for decades and continues to do so. U.S. Br. at 28. Revenue Ruling 90-72 relies on Revenue Ruling 56-249 and explains that it "re-establish[es] the link between SUB pay and state unemployment compensation set forth in Rev. Rul. 56-249." Rev. Rul. 90-72, 1990-2 C.B. 211. Thus, current IRS practice depends upon the very Revenue Ruling that the government suggests may have been impermissible *ab initio*.

*Third*, the government's insistence that SUB payments are "wages" absent a specific exemption puts the United States in the untenable position of arguing in favor of the same type of reliance on the income-tax withholding chapter that it criticizes elsewhere in its brief. To overcome what, in its view, is a possible lack of authority for the IRS in Rev. Rul. 56-249 to treat some SUB payments as non-wages, the government argues that "Congress effectively acquiesced in the IRS's approach . . . by enacting complementary legislation that took the pertinent Revenue Rulings as given and ameliorated their potential unintended consequences." U.S. Br. at 30. As evidence of Congress's acquiescence, the United States cites two provisions: § 501(c)(17) and § 3402(o). *Id.* at 31-32. Both of those provisions are in the income-tax portion of the I.R.C., not the FICA portion. Thus, the United States seeks to bolster its interpretation of the FICA chapter by looking to provisions in the income-tax portion of the I.R.C.,

even as it rejects Quality Stores' reliance on income-tax withholding provisions to interpret FICA. *See id.* at 21 ("Section 3402(o) is not part of FICA, but instead appears in a section of the [I.R.C.] that establishes the substantive rules for income-tax withholding. That is not the correct place to look for guidance in the interpretation of FICA's definitional provisions."); *id.* ("Section 3402(o) has no bearing on FICA's definitional provisions."); *id.* at 22 (referring to the "court of appeals' reliance on Section 3402(o)" as "misguided").

The government cannot have it both ways: it cannot ignore clear indications in the income-tax withholding chapter that no SUB payments are wages, and yet rely on income-tax provisions to support its argument that the IRS has the authority to treat *some* SUB payments as non-wages. There is simply no reason to interpret Congress's actions with respect to SUB payments as acquiescence to treatment of the payments as non-wages for one purpose (income-tax withholding) but not for another (FICA), especially when the IRS itself drew no such distinction.

### B. *Rowan* Continues To Require That "Wages" Be Interpreted Consistently For Income-Tax Withholding And FICA.

The United States appears to have abandoned the argument that *Rowan* has been legislatively overruled—an argument that both the Sixth Circuit below and the Federal Circuit in *CSX* rejected. Pet. App. 14a-17a; *CSX Corp. v. United States*, 518 F.3d 1328, 1344 (Fed. Cir. 2008). But in parts of its brief,

the government nonetheless tries to escape *Rowan*'s clear holding that "Congress intended its definition [of 'wages'] to be interpreted in the same manner for FICA . . . as for income-tax withholding." *Rowan*, 452 U.S. at 263.

Presumably referring to § 3402(o), the United States argues that *Rowan* did not "address whether a statutory provision that governs *substantive* income-tax withholding, and that by its own terms does not apply to FICA, may be construed to narrow FICA's definition of 'wages.'" U.S. Br. at 26. *Rowan*, however, did not instruct reviewing courts to narrow their focus to any particular statutory provisions in determining the meaning of "wages" for purposes of FICA and income-tax withholding. The implicit claim of the United States that § 3402(o) is irrelevant to understanding the definition of "wages" in § 3401(a) lacks any basis in this Court's *Rowan* holding, which focused on consistent interpretation of "wages" across the income-tax withholding and FICA statutory provisions.

The government also misses the mark by claiming that "the interest in 'simplicity and ease of administration,'" an interest this Court stressed in *Rowan* as a reason for consistent interpretation, is "disserved" by the Sixth Circuit's decision. *Id.* (quoting *Rowan*, 452 U.S. at 255). In fact, it is the government's position that undermines the interest in "simplicity and ease of administration." *Rowan*, 452 U.S. at 255. The government argues the Sixth Circuit's holding that SUB payments are not wages contravenes this interest because the IRS cannot treat any SUB payments as "wages" for FICA

purposes, while § 3402(o) requires that all SUB payments are treated as "wages" for income-tax withholding. U.S. Br. at 26-27. The government ignores, however, that the Sixth Circuit's holding provides a bright-line, easily administrable rule, whereas the government's position that *some* SUB payments are non-wages creates complications in administration due to differences between SUB payments and repeated shifts by the IRS about the wage or non-wage status of SUB payments. Resp. Br. at 54-57.[3]

### C. The Government's Attempt To Characterize The SUB Payments At Issue As Particularly Likely To Be Deemed "Wages" Lacks Merit.

The government's claim that "[t]he link between severance payments and prior service is especially clear in . . . this case" is unfounded. U.S. Br. at 12.

*First*, the government argues that the link is clear because "[r]espondents' severance plans provided for payments only to individuals who had

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[3] The cases the government cites are inapposite. *Social Security Board v. Nierotko*, 327 U.S. 358 (1946), involved back pay rather than SUB payments. *See* Resp. Br. 35-37. *Otte v. United States*, 419 U.S. 43 (1974), addressed unpaid wages owed to former employees for services rendered while they were employed. *See* Resp. Br. 35-38. And *Mayo Foundation for Medical Education & Research v. United States*, 131 S. Ct. 704 (2011), considered the scope of the student exception to the definition of wages, not the definition of wages itself. *See* Resp. Br. 38.

been respondents' employees (and thus had performed services on respondents' behalf)." *Id.* This argument is tautological: all SUB payments, by definition, are paid by employers to former employees. 26 U.S.C. § 3402(o)(2)(A) (defining SUB payments as "amounts which are paid to an employee, pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment (whether or not such separation is temporary), resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, but only to the extent such benefits are includible in the employee's gross income").

*Second*, the government argues that "the terms of the payments were tied to particular aspects of the individual employment relationship," citing, *e.g.*, "the length of time they had worked for respondents, and the salaries they had earned during their periods of service." U.S. Br. at 12-13. But the IRS itself has deemed SUB payments that depended on the same type of factors to be non-wages. *See* Rev. Rul. 56-249, 1956-1 C.B. 488. Even Rev. Rul. 90-72, on which the government relies, affords non-wage treatment under FICA to plans in which "the duration of benefits depends in part on the . . . employee's seniority." Rev. Rul. 90-72, 1990-2 C.B. 211.[4]

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[4] Linking SUB payments to aspects of the individual's employment with the former employer is hardly surprising. State unemployment compensation benefits also typically depend upon, for example, the amount of wages the former (continued...)

### D. The Government Attempts To Rewrite § 3402(o) To Support Its Position.

The government asserts that "Section 3402(o) directs that all payments falling within the statutory definition of 'supplemental unemployment compensation benefits' will be subject to income-tax withholding *whether or not* they would otherwise be 'wages.'" U.S. Br. at 28.

The problem with the government's reading of § 3402(o) is that it has no basis in the text of the statute. Contrary to the government's explanation, § 3402(o) does not include the phrase "whether or not they would otherwise be wages." If Congress had wished to indicate—as the government contends—that some SUB payments described in § 3402(o)(1)(A) were within the definition of wages, it could have added the very clarifying phrase the government proposes or a similar phrase, such as "whether or not such payments are wages." It did not do so.

Moreover, this Court has explained that when "'Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.'" *Russello v. United States*,

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employee earned. *See, e.g.*, WASH. REV. CODE ANN. §§ 50.20.120-.1201 (LexisNexis 2013) (providing that the amount of an individual's state unemployment benefits is determined as a percentage of the individual's wages earned during a specified period).

464 U.S. 16, 23 (1983) (quoting *United States v. Wong Kim Bo*, 472 F.2d 720, 722 (5th Cir. 1972)); *see also Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 254 (1992) ("[C]ourts must presume that a legislature says in a statute what it means and means in a statute what it says there."); NORMAN J. SINGER & J.D. SHAMBIE SINGER, STATUTES AND STATUTORY CONSTRUCTION § 46:6 (7th ed. 2007) ("While every word of a statute must be presumed to have been used for a purpose, it is also the case that every word excluded from a statute must be presumed to have been excluded for a purpose.").

Here, Congress specifically used a "whether or not" explanatory phrase in the very subsection at issue. *See* 26 U.S.C. § 3402(o)(2)(A) (defining SUB payments as payments for involuntary employment separation "whether or not such separation is temporary"); *see also* Resp. Br. at 22-23. Congress clearly knows how to clarify when its statutory language speaks broadly, and it did not do so with respect to SUB payments. Congress's omission of a "whether or not" phrase in defining the scope of § 3402(o)(1)(A) is therefore particularly meaningful and must be given effect. The Court should reject the government's attempt to insert statutory language that Congress chose to exclude.

## III. Policy Considerations Support The Conclusion That SUB Payments Are Not Subject To FICA Taxes.

The government argues that treating SUB payments as wages for purposes of FICA is "consistent with IRS guidance," specifically the IRS's Revenue Ruling 90-72. U.S. Br. at 17. Revenue

Ruling 90-72 holds that SUB payments must be "linked to state unemployment compensation in order to be excluded from the definition of wages for FICA . . . tax purposes." Rev. Rul. 90-72, 1990-2 C.B. 211.

1. If the United States is correct that SUB payments are wages for FICA purposes unless they satisfy not only the statutory definition of a SUB payment, but also the IRS's criteria in Rev. Rul. 90-72, then employers will be subject to a burdensome system that produces inconsistent results.

Tying the status of SUB payments as wages or non-wages to whether the SUB payments are "linked to state unemployment compensation" pursuant to Rev. Rul. 90-72 results in a system in which the federal tax status of SUB payments turns on the state of residence of the recipient. Unemployment benefits are not uniform across states. As the U.S. Department of Labor has explained, "There are no federal standards for benefits in terms of qualifying requirements, benefit amounts, or duration of regular benefits. Hence, there is no common pattern of benefit provisions comparable to that in coverage and financing. The states have developed diverse and complex formulas for determining workers' benefit rights." OFFICE OF UNEMPLOYMENT INSURANCE, U.S. DEP'T OF LABOR, UNEMPLOYMENT COMPENSATION FEDERAL-STATE PARTNERSHIP 11 (2010), *available at* http://workforcesecurity.doleta.gov/unemploy/pdf/partnership.pdf. Thus, similarly situated recipients of SUB payments from the *same company* could face different *federal* tax liability depending on the

recipients' state of residence. The U.S. position therefore risks creating a lack of uniformity for the federal tax treatment of SUB payments.

By contrast, the position adopted by the court of appeals, which relies on the text of the federal statutory provisions addressing SUB payments and wages, results in a single, uniform rule that is applicable nationwide and provides the same federal tax treatment to all similarly situated SUB payment recipients.

2. Application of Rev. Rul. 90-72 also imposes undue hardships on individual recipients of SUB payments.

The application of Rev. Rul. 90-72 that the government seeks perversely limits the effectiveness of SUB payments in states in which it is more difficult for individuals to qualify for state unemployment benefits (and thus where SUB payments are most needed). The government recognizes that, as a historical matter, SUB payments "depended for their effectiveness on not being considered 'wages,' because employees in many States were ineligible for unemployment benefits if they were receiving 'wages' from employers." U.S. Br. at 29. But the United States, in advocating application of Rev. Rul. 90-72, unjustifiably runs the link to state unemployment benefits in the opposite direction: Rev. Rul. 90-72 essentially holds that if an individual is not eligible for state unemployment benefits, then the individual also cannot benefit from the non-wage treatment of SUB payments to which they would be entitled if they received state

unemployment benefits. In other words, the government's position insists that an individual either receives *both* the benefit of state unemployment benefits *and* the benefit of non-wage treatment under federal law for their SUB payments, or *neither* benefit. The government has proffered no persuasive reason for adding FICA taxation of SUB payments to the difficulties faced by individuals who are not eligible for state unemployment benefits.

The historical reason for treating SUB payments as non-wages for federal tax purposes—to prevent states from treating the SUB payments as "wages" that would disqualify the recipient from receiving state unemployment benefits—served to *benefit recipients*. It is perverse to use the historical linkage between SUB payments and state unemployment benefits as a reason to *reduce* the value of benefits to recipients.

The historic rationale for linking SUB payments and state unemployment benefits also does not support the particular features originally specified in Rev. Rul. 56-249, 1956-1 C.B. 488, and invoked by the IRS in Rev. Rul. 90-72, 1990-2 C.B. 211, as determining whether SUB payments are wages or not. The list of features is both over- and under-inclusive with respect to how states will treat SUB payments.

It is over-inclusive because some states deny state unemployment benefits based on receipt of SUB payments that qualify for federal non-wage treatment under the Revenue Rulings. For example,

Rev. Rul. 58-128, 1958-1 C.B. 89, permits non-wage treatment for plans unilaterally instituted by the employer. But Oklahoma law treats SUB payments as non-wages for state purposes only if they are paid under an employer-employee or collective bargaining agreement in effect prior to layoff. OKLA. ST. ANN. tit. 40, § 1-225(C)(1)–(3) (West 2013). Similarly, Rev. Rul. 60-330, 1960-2 C.B. 46, permits non-wage treatment for SUB payments paid directly by the employer. But Arizona law treats SUB payments as non-wages only if the employer makes the payments through a plan that qualifies as a supplemental unemployment benefit trust under 26 U.S.C. § 501(c)(17) (*i.e.*, not directly). ARIZ. ADMIN. CODE § R6-3-1705(E)(6), (F) (2012).

The features specified by the IRS are also under-inclusive because some SUB payments that the IRS treats as wages do not affect eligibility for state unemployment benefits and therefore would serve their purpose of supplementing state benefits. For example, Rev. Rul. 90-72, 1990-2 C.B. 211, treats all lump sum payments as wages. But under Arizona law, all SUB payments, including lump-sum payments, made by an employer through a plan that qualifies as a supplemental unemployment benefit trust under 26 U.S.C. § 501(c)(17) are treated as non-wages. ARIZ. ADMIN. CODE § R6-3-1705(F) (2012).

3. The lump-sum provision of Rev. Rul. 90-72 provides an additional reason to reject the government's position. As noted, in addition to holding that SUB payments must be linked to state unemployment compensation to be excluded from wages, Rev. Rul. 90-72 specifies that SUB payments

made as a lump sum "are not considered linked to state unemployment compensation for this purpose, and are therefore not excludable from wages as SUB pay." Rev. Rul. 90-72, 1990-2 C.B. 211. The IRS's position regarding lump sum payments harms individual recipients of SUB payments paid as a lump sum because it treats those lump sum payments as "wages," subject to FICA tax. The lump sum SUB payments may be a crucial supplement to state benefits to enable employees to deal with costs occasioned by sudden loss of employment, initial delay in getting state benefits, and the impact of suddenly finding oneself unemployed.

* * *

For all of these reasons, the government's position that Rev. Rul. 90-72, rather than statutory provisions, should govern the federal "wage" treatment of SUB payments is undesirable as a matter of policy. The government's position creates a cumbersome system in which the federal status of SUB payments depends on variances in state policies and subjects individual SUB payment recipients to inconsistent treatment and undue hardship, contrary to the original purposes of SUB payments.

## CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

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December 2013

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# AMICUS CURIAE BRIEF

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# In the Supreme Court of the United States

UNITED STATES,

*Petitioner,*

v.

QUALITY STORES, INC., et al.,

*Respondents.*

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

## BRIEF OF PROFESSOR KRISTIN E. HICKMAN AS *AMICUS CURIAE* IN SUPPORT OF NEITHER PARTY

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## TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ..... iii

INTEREST OF *AMICUS CURIAE* ..... 1

SUMMARY OF THE ARGUMENT ..... 3

ARGUMENT ..... 5

I. THE LEGAL FORCE AND EFFECT OF REVENUE RULINGS IS PRESENTLY UNCLEAR..... 5

A. The Court Reviews Agency Rules That Carry The Force Of Law Using The *Chevron* Standard..... 5

B. The Court Has Not Explicitly Addressed Whether Revenue Rulings Carry The Force Of Law For The Purpose Of *Chevron* Deference..... 7

C. The Lower Courts Decisions Are Mixed As To Whether Revenue Rulings Carry The Force of Law For The Purpose of *Chevron* Deference..... 10

D. Emerging Lower Court Jurisprudence Holds that Revenue Rulings Carry the Force of Law For APA Procedural Purposes..... 13

II. REVENUE RULINGS CARRY THE FORCE OF LAW..... 16

A. Despite The Historical Informality Of Revenue Rulings, Taxpayers And Tax Return Preparers Now Face Penalties For Noncompliance With Revenue Ruling Interpretations Of Law.....17

B. The Government Has Analogized Revenue Rulings To Treasury Regulations In Arguing For *Chevron* Deference In Past Cases.....25

III. THE COURT SHOULD NOT EXTEND *CHEVRON* DEFERENCE TO REVENUE RULINGS BECAUSE THEY VIOLATE APA PROCEDURAL REQUIREMENTS..... 28

A. Revenue Rulings Violate APA Procedural Requirements..... 28

B. Agency Formats That Systematically Violate APA Procedural Requirements Are Unreasonable.....30

C. *Skidmore* Review Is Not A Remedy.....33

CONCLUSION.....35

## TABLE OF AUTHORITIES

Page(s)

**Cases:**

*Aeroquip-Vickers, Inc. v. Comm'r*,
347 F.3d 173 (6th Cir. 2003)..... 10

*American Bankers Ins. Group v. United States*,
408 F.3d 1328 (11th Cir. 2005)..... 13

*American Hospital Ass'n v. Bowen*,
834 F.2d 1037 (D.C. Cir. 1987)..... 29

*American Mining Congress v. Mine Safety & Health Admin.*, 995 F.2d 1106 (D.C. Cir. 1993)..... 14, 29

*Auer v. Robbins*,
519 U.S. 452 (1997)..... 5

*Bankers Life & Cas. Co. v. United States*,
142 F.3d 973 (7th Cir. 1998).....10

*Barnhart v. Walton*,
535 U.S. 212 (2002)..... 30, 31

*Bowles v. Seminole Rock & Sand Co.*,
325 U.S. 410 (1945)..... 5

*Burks v. United States*,
633 F.3d 347 (5th Cir. 2011).....33

*Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 67 U.S. 837 (1984)..... *passim*

*Christensen v. Harris County*,
529 U.S. 576 (2000)..... 5, 16

*Chrysler Corp. v. Brown*,
441 U.S. 281 (1979)..... 13, 28

*Cohen v. United States*,
578 F.3d 1 (D.C. Cir. 2009) ..... 14, 15, 16

*Cohen v. United States*,
650 F.3d 717 (D.C. Cir. 2011) (*en banc*)..... 15

*Comm'r v. Schleier*,
515 U.S. 323 (1995)..... 8

*Cottage Sav. Ass'n v. Comm'r*,
499 U.S. 554 (1991)..... 9

*Davis v. United States*,
495 U.S. 472 (1990)..... 8, 9

*Dixon v. United States*,
381 U.S. 68 (1965)..... 8, 17

*In re WorldCom, Inc.*,
723 F.3d 346 (2d Cir. 2013)..... 10

*Johnson City Med. Ctr. v. United States*,
999 F.2d 973 (6th Cir. 1993)..... 10

*Judulang v. Holder*, 132 S. Ct. 476 (2011)..... 32

*Kornman & Assocs., Inc. v. United States*,
527 F.3d 443 (5th Cir. 2008)..... 10, 23

*Long Distance Tel. Serv. Fed. Excise Tax Refund Lit.*,
853 F. Supp. 2d 138 (D.D.C. 2012)..... 16

*Mayo Foundation for Medical Education and Research v. United States*,
131 S. Ct. 704 (2011)..... 7, 8, 9, 26

*McLaulin v. Comm'r*,
115 T.C. 255 (2000)..... 10

*Motor Vehicle Manufacturers Association of United States, Inc. v. State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29 (1983)..... 32

*National Muffler Dealers Ass'n v. Commissioner*, 440 U.S. 472 (1970)..... 9

*National Railroad Passenger Corp. v. United States*, 431 F.3d 374 (D.C. Cir. 2006)..... 13

*National Ass'n of Regulatory Utility Comm'rs v. ICC*, 41 F3d 721 (D.C. Cir. 1994)..... 32

*Skidmore v. Swift & Co.*, 323 U.S. 134 (1944)..... *passim*

*Stichting Pensioenfonds Voor de Gezondheid v. United States*, 129 F.3d 195 (D.C. Cir. 1997)..... 18

*Taproot Administrative Services, Inc. v. Commissioner*, 679 F.3d 1109 (9th Cir. 2012)..... 12

*Texaco Inc. v. United States*, 528 F.3d 703 (9th Cir. 2010)..... 12

*Tualatin Valley Builders Supply, Inc. v. United States*, 522 F.3d 937 (9th Cir. 2008)..... 11, 12

*United States v. Cleveland Indians Baseball Co.*, 532 U.S. 200 (2001)..... 9

*United States v. Home Concrete & Supply, LLC*, 132 S. Ct. 1836 (2012)..... 8

*United States v. Mead Corp.*, 533 U.S. 218 (2001)..... *passim*

*United States v. Quality Stores, Inc.*, 693 F.3d 605, (6th Cir. 2013)..... 10

*USA Choice Internet Services, LLC v. United States*, 522 F.3d 1332 (Fed. Cir. 2008)..... 13

**Statutes:**

5 U.S.C. § 553(b)..... *passim*

5 U.S.C. § 706(2)(A)..... 32, 33

5 U.S.C. § 706(2)(D)..... 14, 32

26 U.S.C. § 6662(a)..... 11, 15, 20

26 U.S.C. § 6662(b)(1)..... 11, 15, 20

26 U.S.C. § 6694(b)..... 11, 15

26 U.S.C. § 6694(b)(2)..... 20

26 U.S.C. § 7805(a)..... 21

26 U.S.C. § 9833..... 31

49 U.S.C. § 45301(b)(2)..... 31

Pub. L. No. 94-455, § 1203, 90 Stat. 1520 (1976).... 20

Revenue Act of 1918, Pub. L. No. 254, § 250(b), 40 Stat. 1057, 1083 (1919)..... 19

Revenue Act of 1921, Pub. L. No. 67-98, § 250(b), 42 Stat. 227, 264-65..... 19

**Treasury Regulations and Other Regulatory Materials:**

Internal Revenue Manual,
§ 32.2.2.3.1 (Aug. 11, 2004)..... 18

Internal Revenue Manual,
§ 32.2.2.3.3 (Aug. 11, 2004)..... 14

Introduction, 1953-1 C.B. 1..... 22

Treas. Reg. § 1.6662-3(a)..... 20, 23

Treas. Reg. § 1.6662-3(b)..... 23

Treas. Reg. § 1.6662-3(b)(2)..... 15, 20-21, 23

Treas. Reg. § 1.6662-3(c)(1)..... 23

Treas. Reg. § 1.6694-3(e)..... 18, 20, 21

Treas. Reg. § 301.7805-1(a)..... 7, 22

Treas. Reg. § 601.601(d)(2)(i)(a)..... 17

Treas. Reg. § 601.601(d)(2)(i)(b)..... 11

Treas. Reg. § 601.601(d)(2)(ii)(a)..... 11, 15, 17

Treas. Reg. § 601.601(d)(2)(vi)..... 11

T.D. 8381, 56 Fed. Reg. 67492 (Dec. 31, 1991)11, 20, 21

**Miscellaneous:**

Brief for the Appellant, *U.S.A. Choice Internet Serv., LLC v. United States*,
No. 2007-5077 (Fed. Cir. June 13, 2007), 2007 WL 1997157..... 26, 27

Brief for the Appellant, *Texaco Inc. v. United States*, No. 06-16098 (9th Cir. Sept. 29, 2006), 2006 WL 3623262..... 26, 27

Brief for the Appellee, *AMMEX, Inc. v. United States*, No. 03-5107 (Fed. Cir. Oct. 9, 2003), 2003 WL 24305581..... 29

Brief for the Appellee, *Conopco, Inc. v. United States*, No. 073564 (3d Cir. May 7, 2008), 2008 WL 4126843 ..... 26

Brief for Defendant-Appellant, *Fortis, Inc. v. United States*, No. 05-2518 (2d Cir. Nov. 21, 2005), 2005 WL 5280992..... 26

Charles H. Koch, Jr., Administrative Law and Practice §§ 8:30-8:35 (3d ed. 2010)..... 34

Donald Arthur Winslow, *Tax Penalties—"They Shoot Dogs, Don't They?"*, 43 Fla. L. Rev. 811 (1991)..... 19-20

Donald Korb, *The Four R's Revisited: Regulations, rulings, Reliance, and Retroactivity in the 21st Century: A View From Within*, 46 Duq. L. Rev. 323 (2008)..... 14

H.R. Rep. No. 94-658, reprinted in 1976 U.S.C.C.A.N. 2897 ..... 20, 21

Kathryn J. Sedo & Katrina Wessbecker, *Should Courts Ever Give Deference to Revenue Procedures?*, 134 Tax Notes 225 (2012)..... 11

Kristin E. Hickman, *IRB Guidance: The No Man's Land of Tax Code Interpretation*, 2009 Mich. St. L. Rev. 239..... 2, 11-12, 15, 19

Kristin Hickman, *Unpacking the Force of Law*, 66 Vand. L. Rev. 465 (2013)..... 35

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S. Rep. No. 94-938, pt. 1, (1976), reprinted in 1976 U.S.C.C.A.N. 3439..... 21

Thomas W Merrill & Kathryn Tongue Watts, *Agency Rules with the Force of Law: The Original Convention*, 116 Harv. L. Rev. 467 (2002).... 24, 25

Thomas W. Merrill, *The* Mead *Doctrine: Rules and Standards, Meta-Rules and Meta-Standards*, 54 Admin. L. Rev. 807 (2002)..... 24

## Interest of *Amicus Curiae*[1]

*Amicus* is the Harlan Albert Rogers Professor of Law at the University of Minnesota Law School. She teaches and writes in the areas of tax law, administrative law, and tax administration. *Amicus* has a longstanding academic interest in an issue implicated by this case: the standard of review for revenue rulings. *Amicus* has written extensively about judicial review of agency legal interpretations. *See, e.g.*, Kristin E. Hickman & Matthew D. Krueger, *In Search of the Modern* Skidmore *Standard*, 107 Colum. L. Rev. 1235 (2007); Thomas W Merrill & Kristin E. Hickman, Chevron's *Domain*, 89 Geo. L.J. 833 (2001). Opinions of this Court have previously cited *Amicus*'s work regarding the scope of *Chevron* review. *See United States v. Mead Corp.*, 533 U.S. 218, 230 n.11 (2001); *City of Arlington, Tex. v. FCC*, 133 S.Ct. 1863, 1885 (2013) (Roberts, C.J. dissenting). *Amicus* has also written extensively about the legal status of revenue rulings under this Court's deference jurisprudence as well as Administrative Procedure Act (APA) procedural requirements. *See* Kristin E. Hickman, *Unpacking the Force of Law*, 66 Vand. L. Rev. 465 (2013); Kristin E. Hickman, *IRB Guidance:*

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[1] Consistent with Supreme Court Rule 37.3(a), *Amicus* files this brief with the written consent of both parties. Consistent with Supreme Court Rule 37.6, *Amicus* hereby certifies that this brief was not authored in whole or in part by counsel for any party and that *Amicus* received no monetary contribution toward the preparation or submission of this brief other than the general financial support of the academic institution with which she is affiliated.

*The No Man's Land of Tax Code Interpretation*, 2009 Mich. St. L. Rev. 239.

Both before this Court and in the lower courts, as support for its conclusion that severance payments are subject to FICA taxation, the government has relied substantially on revenue rulings in which the Internal Revenue Service (IRS) articulated its interpretation of "wages" as defined by Internal Revenue Code (IRC) § 3121(a). While not raised as an issue by the parties and barely discussed by recent circuit court decisions evaluating the meaning of IRC § 3121(a), the standard of review for revenue rulings is an unresolved, hotly debated, and surprisingly complicated issue. Any resolution of this issue will reach far beyond severance payments and FICA taxes.

Tax administration would undoubtedly benefit from virtually any Court guidance regarding the standard of review for revenue rulings. But given that the litigation over the meaning of IRC § 3121(a) thus far has failed to highlight the standard of review issue, *Amicus* is the concerned that the Court could address the legal status of revenue rulings without being aware of the controversy surrounding them. Consistent with her scholarly interests, *Amicus* submits this brief solely to inform the Court of the lower courts' confusion and highlight the circumstances complicating resolution of the standard of review for revenue rulings.

*Amicus* disclaims any view regarding the proper interpretation of IRC § 3121(a) and will not address that issue. *Amicus* hopes this brief will

assist the Court in considering the important question of administrative law and tax administration raised by this case.

## SUMMARY OF THE ARGUMENT

The Court has not squarely addressed whether revenue rulings are eligible for judicial review under the highly deferential standard articulated by the Court in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (2001), or the lesser judicial respect counseled by the Court in *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944). According to the Court's decision in *United States v. Mead Corp.*, 533 U.S. 218 (2001), the answer depends upon whether revenue rulings carry "the force of law." *Id.* at 227. The Court's statements on the issue are inconclusive, and the lower courts have struggled to resolve the question, with mixed results.

Whether *Chevron* or *Skidmore* provides the appropriate evaluative standard for revenue rulings is a challenging question. At first blush, revenue rulings look like informal guidance of the sort typically associated with *Skidmore* review. The IRS issues revenue rulings without public notice and opportunity for comment. Historically, revenue rulings were considered to be lacking the force of law.

But first looks can be deceiving. As a result of 1991 Treasury regulations, taxpayers and tax return preparers now face financial penalties for failing to comply with revenue rulings. For this and other reasons, the government in past litigation has analogized revenue rulings to Treasury regulations

and claimed that revenue rulings represent an exercise of congressionally delegated power to act with the force of law. For these reasons, revenue rulings would seem to carry the force of law and qualify for *Chevron* review.

Nevertheless, while *Chevron* rather than *Skidmore* review seems appropriate for revenue rulings, the Court should resist any call to apply *Chevron* to defer to IRS interpretations of ambiguous IRC provisions advanced through revenue rulings. The very characteristics of revenue rulings that seemingly entitle them to *Chevron* review simultaneously categorize revenue rulings as legislative rules subject to Administrative Procedure Act notice-and-comment rulemaking requirements. Yet, the IRS did not use notice-and-comment rulemaking when it issued the revenue rulings cited by the government in this case, and in fact never uses notice-and-comment rulemaking in promulgating revenue rulings. In other words, revenue rulings as a class always violate APA procedural requirements. Agency rules that systematically violate APA procedural requirements in this way ought not to be eligible judicial deference under *Chevron*. The most appropriate resolution, however, is not *Skidmore* review. Rather, the Court should simply invalidate revenue rulings as unreasonable at *Chevron* step two and resolve the case without deference to the IRS.

## ARGUMENT

### I. THE LEGAL FORCE AND EFFECT OF REVENUE RULINGS IS PRESENTLY UNCLEAR

The standard of review for revenue rulings as a format for communicating IRS legal interpretations is an unresolved and complicated question of law. The Court's precedents regarding the issue are sparse and inconclusive. While the lower courts are not quite split outright over the legal force and effect of revenue rulings, decisions among the circuit courts of appeal reflect both confusion and an emerging disagreement over that question.

#### A. The Court Reviews Agency Rules That Carry The Force Of Law Using The *Chevron* Standard

For several years, the Court has recognized two competing standards of review for evaluating the substantive validity of agency statutory interpretations.[2] *See United States v. Mead Corp.*,

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[2] The Court historically has applied yet another standard in evaluating agency interpretations of agency regulations—that of *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410 (1945), and *Auer v. Robbins*, 519 U.S. 452 (1997). Although the government's brief cites and quotes from various Treasury regulations, in considering the treatment of severance payments for FICA tax purposes, none of the IRS in its revenue rulings, the lower courts, or the government in its brief here have characterized the government's position as an interpretation of those regulations, rather than of the IRC. Accordingly, the scope and applicability of the *Seminole Rock/Auer* standard does not appear to be at issue in this case.

533 U.S. 218, 226-27 (2001); *Christensen v. Harris County*, 529 U.S. 576, 586-87 (2000). The first, articulated by the Court in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), requires a two-step approach. First, the Court assesses the clarity of the relevant statute. *Id.* at 842. If the statute's meaning is clear, that is the end of the inquiry, for both agencies and courts must abide by clearly expressed congressional intent. *Id.* at 842-43. If the statute is ambiguous, however, then the second step of the *Chevron* standard calls upon reviewing courts to defer to any interpretation thereof that is reasonable or permissible and not arbitrary or capricious. *Id.* at 843.

The second standard that the Court uses in considering challenges to agency legal interpretations is that articulated in *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944). *Skidmore* and its progeny call upon reviewing courts to consider various factors in determining the degree of deference that is appropriate for a given agency legal interpretation, including "the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control." *Id.* at 140.

In *United States v. Mead Corp.*, 533 U.S. 218 (2001), the Court adopted a two-part test for evaluating whether a particular agency legal interpretation is eligible for *Chevron* rather than *Skidmore* review. *Id.* at 226-27. First, the Court asks whether Congress has given the agency in question the authority to bind regulated parties with

"the force of law." *Id.* If Congress has made such a delegation, then the Court requires whether the agency has "exercise[d] ... that authority." *Id.* Where the answers to both of *Mead*'s questions are affirmative, then *Chevron*'s two-part standard of review applies. *See id.* at 327-38. If the answer to either of *Mead*'s two questions is negative, however, then *Skidmore* offers the appropriate evaluative standard. *Id.* at 237-38.

### B. The Court Has Not Explicitly Addressed Whether Revenue Rulings Carry The Force Of Law For The Purpose Of *Chevron* Deference

Applying *Mead*'s first step to the tax context, there can be little doubt that the IRS possesses congressionally-delegated authority to act with the force of law. IRC § 7805(a) authorizes the Secretary of the Treasury (Treasury) to "prescribe all needful rules and regulations for the enforcement" of the IRC. In *Mayo Foundation for Medical Education and Research v. United States*, 131 S. Ct. 704 (2011), the Court held that, by this language, Congress had delegated to Treasury the power to act with the force and effect of law. *Id.* at 714. Presumably the same holding extends to the IRS as Treasury's delegee. *See* Treas. Reg. § 301.7805-1(a) (authorizing the Commissioner similarly to "prescribe all needful rules and regulations for the enforcement of the [IRC]").

Just because Treasury and the IRS possess the requisite authority to act with the force of law, however, does not mean that every interpretive

pronouncement they make represents an exercise of that power. The second part of the *Mead* test for *Chevron* eligibility recognizes as much when it asks whether an agency that possesses the power to act with legal force has in fact chosen to exercise that authority. *Mead*, 533 U.S. at 226-27. The *Mayo Foundation* case concerned a Treasury regulation promulgated using notice-and-comment rulemaking, not a revenue ruling. *See Mayo Foundation*, 131 S. Ct. at 714. The Court has never evaluated revenue rulings under *Mead*'s second step, and pre-*Mead* assessments are not especially illuminating.

Long before the Court decided *Mead* and *Chevron*, in *Dixon v. United States*, the Court concluded that "[t]he Commissioner's rulings have only such force as Congress chooses to give them, and Congress has not given them the force of law." 381 U.S. 68, 73 (1965). As discussed in Part II below, however, the legal status of revenue rulings has changed substantially since the Court decided *Dixon*. Moreover, the Court has been reluctant to ascribe post-*Chevron* meaning to pre-*Chevron* judicial use of key terms. *See United States v. Home Concrete & Supply, LLC*, 132 S. Ct. 1836, 1843-44 (2012) (cautioning against reading the Court's reference to statutory ambiguity in 1958 as reflecting a post-*Chevron* conclusion about congressional delegation).

More recently, the Court has recognized that revenue rulings lack "the force and effect of regulations." *Comm'r v. Schleier*, 515 U.S. 323, 336 n.8 (1995) (quoting *Davis v. United States*, 495 U.S. 472, 484 (1990)). But even setting aside that such statements pre-date *Mead*, it does not automatically

follow that lacking the legal force of Treasury regulations means that revenue rulings lack the force of law for purposes of *Mead* and *Chevron*.

In *Davis v. United States*, the Court gave "considerable weight" to revenue rulings "where they involve the contemporaneous construction of a statute and where they have been in long use," but cited precedent that predates all of *Mead*, *Chevron*, and *Skidmore* for that proposition. *Davis*, *supra*, at 484 (citing *Norwegian Nitrogen Products Co. v. United States*, 288 U.S. 294, 315 (1933)). In *Cottage Sav. Ass'n v. Comm'r*, 499 U.S. 554 (1991), the Court intimated without deciding that the tax-specific judicial deference standard articulated in *National Muffler Dealers Ass'n v. Commissioner*, 440 U.S. 472 (1970), might apply to revenue rulings. *Cottage Sav.*, *supra*, at 563 n.7. The continued vitality of the *National Muffler* standard for any purpose was placed in substantial doubt, however, by the Court's decision in the *Mayo Foundation* case. *See Mayo Foundation*, 131 S. Ct. at 713 (rejecting tax exceptionalism from general administrative law standards of judicial review). Most recently, but still pre-*Mead*, in *United States v. Cleveland Indians Baseball Co.*, 532 U.S. 200 (2001), the Court extended "substantial judicial deference" to a "longstanding" IRS interpretation of the FICA tax provisions that had been documented in revenue rulings, but expressly without "decid[ing] whether the Revenue Rulings themselves are entitled to deference." *Id.* at 220.

### C. The Lower Courts Decisions Are Mixed As To Whether Revenue Rulings Carry The Force of Law For Purposes of *Chevron* Deference

In the decade before the Court decided *Mead*, the lower courts employed a range of standards in evaluating revenue rulings. The United States Tax Court utilized de novo review with no deference whatsoever. *See, e.g., McLaulin v. Comm'r*, 115 T.C. 255, 263 (2000) ("We generally treat a revenue ruling as merely the Commissioner's litigating position not entitled to any judicial deference or precedential weight."). Some circuit courts adopted an attitude of intermediate deference or respect. *See, e.g., Bankers Life & Cas. Co. v. United States*, 142 F.3d 973, 978 (7th Cir. 1998) (extending "some weight" or "respectful consideration" to revenue rulings). Still other courts extended *Chevron* deference to revenue rulings. *See, e.g., Johnson City Med. Ctr. v. United States*, 999 F.2d 973, 977 (6th Cir. 1993).

Since the Court's decision in *Mead*, some circuits have opted for *Skidmore* rather than *Chevron* review for revenue rulings. In the case at bar, the Sixth Circuit noted its own post-*Mead* precedent extending only *Skidmore* rather than *Chevron* review to revenue rulings. *See United States v. Quality Stores, Inc.*, 693 F.3d 605, 619 (6th Cir. 2013) (citing *Aeroquip-Vickers, Inc. v. Comm'r*, 347 F.3d 173, 181 (6th Cir. 2003)). The Fifth Circuit and the Second Circuit have also held that revenue rulings are not entitled to *Chevron* deference. *See In re WorldCom, Inc.*, 723 F.3d 346, 357-58 (2d Cir. 2013); *Kornman &*

*Assocs., Inc. v. United States*, 527 F.3d 443, 454 & n.9 (5th Cir. 2008).

Other circuits however have deliberately left open whether *Chevron* or *Skidmore* provides the appropriate evaluative standard for revenue rulings. In particular, the Ninth Circuit has reserved the question repeatedly since Judge Dairmuid O'Scannlain wrote a concurring opinion in which he observed that the circuit's cases were in tension. *See Tualatin Valley Builders Supply, Inc. v. United States*, 522 f.3d 937, 945-46 (9th Cir. 2008) (O'Scannlain, J., specially concurring). The *Tualatin Valley* case concerned a different but analogous IRS format called a revenue procedure, rather than a revenue ruling.[3] In his *Tualatin Valley* opinion,

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[3] A revenue procedure is "a statement of procedure that affects the rights and duties of taxpayers or other members of the public under the [IRC] and related statutes or information that, although not necessarily affecting rights and duties of the public, should be a matter of knowledge." Treas. Reg. § 601.601(d)(2)(i)(b). Although many revenue procedures address only procedural matters, others contain substantive interpretations of law. *See* Kathryn J. Sedo & Katrina Wessbecker, *Should Courts Ever Give Deference to Revenue Procedures?*, 134 Tax Notes 225, 227-33 (2012) (offering examples of substantive revenue procedures); Kristin E. Hickman, *IRB Guidance: The No Man's Land of Tax Code Interpretation*, 2009 Mich. St. L. Rev. 239, 247-49 (describing contemporary IRS use of revenue procedures). Like revenue rulings, revenue procedures are published by the IRS in the Internal Revenue Bulletin, "the authoritative instrument of the Commissioner of Internal Revenue for the publication of official rulings and procedures of the IRS." Treas. Reg. § 601.601(d)(2)(ii)(a), (vi). Noncompliance with some revenue procedures may lead to penalties for taxpayers and tax return preparers. *See* 26 U.S.C. §§ 6662(a)-(b)(1), 6694(b) (imposing

Judge O'Scannlain suggested first that courts ought to apply *Mead*'s analysis to each revenue procedure independently, rather than to all revenue procedures as a class. *Id.* at 946. He then went on to conclude that *Chevron* deference ought to apply at least to the revenue procedure at issue as an exercise of delegated power, irrespective of the document's lack of notice and comment. *Id.* Subsequently, the Ninth Circuit acknowledged Judge O'Scannlain's *Tualatin Valley* opinion in reserving the question of *Chevron* versus *Skidmore* deference for revenue rulings. *See Texaco Inc. v. United States*, 528 F.3d 703, 711 & n.8 (9th Cir. 2010). Most recently, in *Taproot Administrative Services, Inc. v. Commissioner*, the Ninth Circuit reiterated its reservation regarding the level of deference due to revenue rulings, notwithstanding the government's concession in that case that *Skidmore* provided the appropriate evaluative standard. 679 F.3d 1109, 1115-16 & n.14 (9th Cir. 2012) ("This Court, however, has not definitively resolved the issue of whether revenue rulings are entitled to *Skidmore* deference or the deference articulated by the Supreme Court in [*Chevron*].").

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penalties for failure to comply with "rules or regulations"); T.D. 8381, 56 Fed. Reg. 67492 (Dec. 31, 1991) (adopting regulations defining "rules and regulations" as used in 26 U.S.C. §§ 6662 and 6694, and indicating that revenue procedures "may or may not be treated as 'rules or regulations' depending on all facts and circumstances"). Along with a third IRS format called a notice, therefore, revenue procedures are often legally and practically analogous to revenue rulings. *See* Hickman, *IRB Guidance*, *supra*, at 242-52 (comparing and contrasting the revenue ruling, revenue procedure, and notice formats, and the IRS's utilization thereof).

In addition to the Ninth Circuit, at least three other circuits have recognized the issue but declined to resolve whether *Chevron* or *Skidmore* provides the appropriate standard of review for revenue rulings. *See USA Choice Internet Services, LLC v. United States*, 522 F.3d 1332, 1342 (Fed. Cir. 2008) ("[W]e need not address the extent of deference—if any—properly accorded to [revenue rulings]."); *Nat'l Railroad Passenger Corp. v. United States*, 431 F.3d 374, 379 (D.C. Cir. 2006) ("[A]lthough the parties discuss whether we should defer to Revenue Ruling 79-404 pursuant to [*Chevron* or *Skidmore*], we need not resolve that question."); *Am. Bankers Ins. Group v. United States*, 408 F.3d 1328, 1335 (11th Cir. 2005) ("[W]e need not determine the proper level of deference to be given Revenue Ruling 79-404.").

### D. Emerging Lower Court Jurisprudence Holds that Revenue Rulings Carry the Force of Law For APA Procedural Purposes

*Mead* and its progeny are not the only context in which courts endeavor to distinguish agency rules that carry the force of law from those that do not. In *Chrysler Corp. v. Brown*, 441 U.S. 281 (1979), the Court drew a direct line between agency rules that carry the force of law and APA procedural requirements. *See id.* at 301-03.

APA § 553 requires that agencies engaging in rulemaking utilize notice-and-comment rulemaking unless the rule in question qualifies for one of several statutory exceptions—for interpretative rules, procedural rules, policy statements, and good cause.

*See* 5 U.S.C. § 553(b), (c). Generally, agency rules that do not qualify for one of these exceptions are legally invalid if they fail to comply with the procedural requirements of APA § 553. *See* 5 U.S.C. § 706(2)(D) (instructing reviewing courts to invalidate agency actions found to be "without observance of procedure required by law"). Established administrative law doctrine holds in turn that properly promulgated legislative rules carry the force of law, binding members of the public, the government, and even courts to the extent such rules represent a legitimate exercise of agency authority. *See, e.g.*, 1 Richard J. Pierce, Jr., Administrative Law Treatise § 6.4 (5th ed. 2010). Hence, courts evaluating particularly whether agency rules are eligible for the interpretative rule exception often ask whether the rules in question carry the force of law. *See, e.g., American Mining Congress v. Mine Safety & Health Admin.*, 995 F.2d 1106, 1109 (D.C. Cir. 1993) ("We have said that a rule has such force only if Congress has delegated legislative power to the agency and if the agency intended to exercise that power in promulgating the rule.").

In *Cohen v. United States*, 578 F.3d 1 (D.C. Cir. 2009), the D.C. Circuit considered the justiciability of an Administrative Procedure Act procedural challenge to an IRS notice—which, like revenue procedures, is an IRS format analogous to a revenue ruling.[4] The D.C. Circuit concluded that the notice

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[4] Notices are "public pronouncement[s] by the [IRS] that may contain guidance that involves substantive interpretations of the Internal Revenue Code or other provisions of" the tax laws. Internal Revenue Manual § 32.2.2.3.3 (Aug. 11, 2004); *see also*

was justiciable as providing "a binding standard" that "alters the legal obligations of service providers charged with collecting" the taxes at issue, "changes taxpayers' rights and obligations," and thus "operates as a substantive rule that binds the IRS . . . and taxpayers." 578 F.3d 1, 6-9 (D.C. Cir. 2009), *vacated in part pending rehearing en banc*, 599 F.3d 652 (D.C. Cir. 2010). Upon rehearing with respect to different justiciability questions, the *en banc* court reinforced the panel's earlier assessment: "Put simply, 'Notice 2006-50 binds the IRS.'" *Cohen v. United States*, 650 F.3d 717, 723 (D.C. Cir. 2011) (en banc) (quoting *Cohen v. United States*, 578 F.3d 1, 8 (D.C. Cir. 2009)). Although the *Cohen* court's decision concerned the justiciability rather than the merits of the taxpayers' APA procedural claim, on remand, the district court discussed the implications of the D.C.

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Donald Korb, *The Four R's Revisited: Regulations, Rulings, Reliance, and Retroactivity in the 21st Century: A View From Within*, 46 Duq. L. Rev. 323, 330-72 (2008) (discussing legal authority of IRS formats from perspective of IRS Chief Counsel). Like revenue rulings, notices are published in the Internal Revenue Bulletin, "the authoritative instrument of the Commissioner of Internal Revenue for the publication of official rulings and procedures of the IRS." Treas. Reg. § 601.601(d)(2)(ii). Taxpayers and tax return preparers may be penalized for failing to comply with notices. *See* 26 U.S.C. §§ 6662(a)-(b)(1), 6694(b) (imposing penalties for failure to comply with "rules or regulations"); Treas. Reg. §§ 1.6662-3(b)(2) and 1.6694-3(e) (defining "rules and regulations" as used in IRC §§ 6662 and 6694 as including notices). Like revenue procedures, notices are often legally and practically analogous to revenue rulings. *See* Hickman, *IRB Guidance*, *supra*, at 242-52 (comparing and contrasting the revenue ruling, revenue procedure, and notice formats, and the IRS's utilization thereof).

Circuit's decision for that claim: "Simply stated, because Notice 2006-50 is binding, the [government] was required to abide by the APA's notice-and-comment requirements, or to, alternatively, provide good cause for not doing so." In re *Long Distance Tel. Serv. Fed. Excise Tax Refund Lit.*, 853 F. Supp. 2d 138, 142-43 (D.D.C. 2012).

In short, the outcome of the *Cohen* litigation was a conclusion that an IRS guidance document that is analogous to a revenue ruling carried the force of law for purposes of the procedural requirements of APA § 553. The Court has never precisely equated the force of law for APA compliance purposes with the force of law under *Mead* and *Chevron*. Nevertheless, absent congressional authorization to disregard APA notice and comment requirements, it is difficult to imagine many situations in which a rule carries the force of law for APA § 553 procedural requirements but lacks the force of law for *Mead* and *Chevron*. Accordingly, the D.C. Circuit's analysis in Cohen may be expected to influence courts evaluating whether revenue rulings carry the force of law for *Mead* and *Chevron*.

## II. REVENUE RULINGS CARRY THE FORCE OF LAW

Resolving the standard of review for revenue rulings is challenging. On their face, revenue rulings look like informal guidance of the sort typically associated with *Skidmore* review. *Cf. Christensen v. Harris County*, 529 U.S. 576, 587 (2000) (listing opinion letters, policy statements, agency manuals, and enforcement guidelines as types of agency action

that lack the force of law and warrant only *Skidmore* "respect"). As it always has done, the IRS issues revenue rulings without public notice and opportunity to comment. As noted above, historically, revenue rulings were viewed as lacking the force of law. *See Dixon v. United States*, 381 U.S. 68, 73 (1965).

Digging deeper changes the picture. As a result of 1991 Treasury regulations extending IRC penalty provisions to noncompliance with revenue rulings, however, the legal weight of revenue rulings has changed. Taxpayers and tax return preparers may now face financial penalties for failing to comply with revenue rulings. For this and other reasons, the government in past litigation has analogized revenue rulings to Treasury regulations in arguing for *Chevron* deference.

### A. Despite The Historical Informality Of Revenue Rulings, Taxpayers And Tax Return Preparers Now Face Penalties For Noncompliance With Revenue Ruling Interpretations Of Law.

Revenue rulings appear substantially less formal than Treasury regulations. This appearance belies their significance as an instrument of tax administration. Revenue rulings are official and authoritative IRS pronouncements. Treas. Reg. § 601.601(d)(2)(i)(a) ("A Revenue Ruling is an official interpretation by the Service that has been issued in the Internal Revenue Bulletin."); *see also* Treas. Reg. § 601.601(d)(2)(ii)(a) (describing the Internal Revenue

Bulletin, in which revenue rulings are published, as "the authoritative instrument of the Commissioner of Internal Revenue for the publication of official rulings and procedures of the [IRS]"); *Stichting Pensioenfonds Voor de Gezondheid v. United States*, 129 F.3d 195, 198 (D.C. Cir. 1997) (describing revenue rulings as "the second most important agency pronouncements that interpret the [IRC]").

The IRS originally adopted the revenue ruling format in 1953 to address in a more generalized form substantive legal questions that were identified and otherwise addressed through unpublished private letter rulings issued to individual taxpayers and through litigation. *See* Mitchell Rogovin, *The Four R's: Regulations, Rulings, Reliance and Retroactivity: A View from Within*, 43 Taxes 756, 763-67 (1965) (documenting the history of revenue rulings). Hence, the IRS describes revenue rulings as "the conclusion of the [IRS] on how the law is applied to a specific set of facts." Internal Revenue Manual § 32.2.2.3.1 (Aug. 11, 2004). Many revenue rulings follow a simple format of offering one or more hypothetical fact patterns; identifying a particular legal issue raised thereby; analyzing the relevant statutory provisions, Treasury regulations, and judicial opinions that inform the issue; and finally reaching a holding or conclusion as to the proper tax treatment of the facts as outlined. Other revenue rulings acknowledge a particular source of ambiguity in the Internal Revenue Code, articulate various guiding principles that the IRS considers relevant in resolving the ambiguity, and provide examples demonstrating the application of those principles. Still other revenue

rulings summarize facts, legal analysis, and conclusions of court cases for the purpose of announcing that the IRS will or will not acquiesce in their holdings. *See* Hickman, *IRB Guidance*, *supra*, at 244-46 (documenting IRS use of the revenue ruling format). While not all revenue rulings fit one of these patterns, those at issue in the case at bar certainly do.

Historically, noncompliance with revenue rulings did not give rise to statutory penalties. Penalties for underpayment of taxes due to "negligence" or "intentional disregard" of tax "rules and regulations" have been part of the tax laws since 1918 and 1921, respectively—long before the IRS ever conceived of revenue rulings. *See* Revenue Act of 1918, Pub. L. No. 254, § 250(b), 40 Stat. 1057, 1083 (1919) (adopting the negligence penalty); Revenue Act of 1921, Pub. L. No. 67-98, § 250(b), 42 Stat. 227, 264-65 (adding language regarding intentional disregard of rules and regulations). Congress did not define "rules or regulations" or otherwise elaborate the scope of these penalty provisions, however, and legislative history offered few insights regarding Congress's intended meaning. As a result, for decades after the penalties' enactment, courts declined to apply them so long as taxpayers could articulate a reasonable argument for the inapplicability or invalidity of virtually any tax rule or regulation. *See, e.g.*, Michael Asimow, *Civil Penalties for Inaccurate and Delinquent Tax Returns*, 23 UCLA L. Rev. 637, 659 (1976) (recounting the early treatment of the intentional disregard penalty); Donald Arthur Winslow, *Tax Penalties—"They Shoot*

*Dogs, Don't They?*", 43 Fla. L. Rev. 811, 836-43 (1991) (describing the history and application of the negligence penalty).

The contemporary IRC similarly imposes a penalty equal to 20% of any tax underpayment due to "negligence or disregard of tax rules of regulations." 26 U.S.C. § 6662(a) & (b)(1). Also, as part of the Tax Reform Act of 1976, Congress adopted new penalties for tax return preparers found guilty of "negligent or intentional disregard of rules and regulations." Pub. L. No. 94-455, § 1203, 90 Stat. 1520, 1689 (1976). Congress has subsequently adjusted the preparer penalty so that it now applies to "reckless or intentional disregard of rules and regulations." 26 U.S.C. § 6694(b)(2). Still, however, Congress has failed to define what it meant by "rules and regulations," although the 1976 House and Senate Reports stated that the new preparer penalty and existing underpayment penalties for taxpayer disregard of tax rules and regulations should be read similarly. *See* H.R. Rep. No. 94-658, at 278 (1975), reprinted in 1976 U.S.C.C.A.N. 2897, 3174; S. Rep. No. 94-938, pt. 1, at 355-56 (1976), reprinted in 1976 U.S.C.C.A.N. 3439, 3784-85.

In 1991, Treasury adopted Treas. Reg. §§ 1.6662-3 and 1.6694-3, in which it defined "rules and regulations" for both the underpayment and preparer penalties. T.D. 8381, 56 Fed. Reg. 67492 (Dec. 31, 1991). The regulatory definition expressly includes revenue rulings among several listed formats. *See* Treas. Reg. § 1.6662-3(b)(2) ("The term 'rules or regulations' includes . . revenue rulings . . . issued by the Internal Revenue Service and published in the

Internal Revenue Bulletin."); Treas. Reg. § 1.6694-3(e) (same). In response to comments objecting to the inclusion of revenue rulings on the ground that those documents lack notice and comment, Treasury contended that the 1976 legislative history "expressly provides that rules and regulations include regulations and 'IRS rulings.'" T.D. 8381, 56 Fed. Reg. 67492, 67494 (Dec. 31, 1991).

The legislative history cited by Treasury provides at best a weak foundation for concluding that Congress intended to extend the IRC's penalty provisions to revenue rulings. In discussing the new tax return preparer penalty, the 1976 Senate Report cited by Treasury, and its corresponding House counterpart, both refer mostly to "rules and regulations," tracking the long-time statutory language without elaboration. H.R. Rep. No. 94-658, *supra*, at 278; S. Rep. No. 94-938, *supra*, at 355-56. In a few instances, the Senate and House Reports substitute the term "rulings" for "rules," and in one instance the history speaks of "IRS regulations and rulings." H.R. Rep. No. 94-658, *supra*, at 278; S. Rep. No. 94-938, *supra*, at 355-56. The legislative history does not specifically mention revenue rulings by name, even though by that time the IRS had been issuing revenue rulings for more than twenty years.

Nevertheless, "rules and regulations" remains undefined statutorily, while Congress has clearly authorized Treasury to resolve ambiguities in the IRC by regulation. 26 U.S.C. § 7805(a) (authorizing Treasury to "prescribe all needful rules and regulations for the enforcement of" the IRC). Exercising its congressionally delegated power, as

outlined above, Treasury has adopted binding regulations proclaiming that statutory penalties apply to taxpayers and tax return preparers who fail to comply with the interpretations contained in revenue rulings. Treasury has also delegated to the IRS its authority to prescribe rules and regulations. Treas. Reg. § 301.7805-1(a) (delegating Treasury's authority to prescribe rules and regulations to the IRS). Taken together, Treasury has clearly embraced the position that Congress has delegated to it and to the IRS as its delegee the power to bind regulated parties with the force of law using revenue rulings. Consistent with the requirement of *Mead*'s second step, therefore, in using revenue rulings to communicate interpretations of the IRC, the IRS signals its intent to exercise that delegated power.

The IRS continues to claim that revenue rulings lack the force and effect of Treasury regulations. This assertion is included in the introduction to every issue of the Internal Revenue Bulletin and dates at least to the 1953 bi-annual cumulation of that year's publications, known as the Cumulative Bulletin. *See* Introduction, 1953-1 C.B. 1 ("Revenue Rulings reported in the Bulletin do not have the force and effect of Treasury Department Regulations (including Treasury Decisions)."). Admittedly, the standard for assessing penalties for failing to follow revenue rulings is more relaxed than that for Treasury regulations. Taxpayers who adopt return positions inconsistent with Treasury regulations must both disclose their noncompliance on their tax returns and have a "reasonable basis" for the position taken to avoid the penalties imposed by

IRC § 6662(b)(1). Treas. Reg. § 1.6662-3(b). Furthermore, a taxpayer's decision not to comply with a Treasury regulation must represent "a good faith challenge to the validity of the regulation." Treas. Reg. § 1.6662-3(c)(1). By comparison, a taxpayer who declines or otherwise fails to follow a revenue ruling is exempt from the penalties imposed by IRC § 6662(b)(1) if the taxpayer's position "has a realistic possibility of being sustained on the merits," whether or not the taxpayer discloses the noncompliance or intends to challenge the rule's validity. Treas. Reg. § 1.6662-3(a), (b)(2).

In concluding that revenue rulings lack the force of law for purposes of *Mead* and *Chevron*, the Fifth Circuit noted in passing the more lenient penalty standard associated with revenue rulings as opposed to regulations. *See Kornman & Assoc., Inc. v. United States*, 527 F.3d 443, 454 (5th Cir. 2008) (citing Kristin E. Hickman, *Coloring Outside the Lines: Examining Treasury's (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements*, 82 Notre Dame L. Rev. 1727, 1804 n.365 (2007)). If the goal is to determine whether agency actions carry the force of law, however, then distinguishing between Treasury regulations and revenue rulings based on the relative severity or leniency of Treasury's penalty standards would seem to draw the line in the wrong place. Under either standard, the government seeks to impose penalties for noncompliance on at least some taxpayers who fail to comply with interpretations advanced in the formats in question. If one associates congressionally imposed penalty provisions (and agency

interpretations thereof) with the delegation of authority to act with the force of law, then the relevant line would seem instead to be between formats that carry penalties and those that do not.

The Court has never expressly identified penalty potential as a characteristic indicating that a particular interpretive format carries the force of law, whether for *Mead* and *Chevron* or otherwise. Nevertheless, the Court has directly connected *Mead*'s force of law touchstone for *Chevron* deference to the principle of congressional delegation. *See Mead*, 533 U.S. 218, 226-27, 229 (2001). Professors Thomas Merrill and Kathryn Watts have documented exhaustively that, at least in the context of agency rulemaking, Congress historically signaled its intent to delegate legislative power through provisions imposing penalties or similar consequences for noncompliance with agency commands. *See* Thomas W. Merrill & Kathryn Tongue Watts, *Agency Rules with the Force of Law: The Original Convention*, 116 Harv. L. Rev. 467, 472 (2002); *see also* Thomas W. Merrill, *The* Mead *Doctrine: Rules and Standards, Meta-Rules and Meta-Standards*, 54 Admin. L. Rev. 807, 829 (2002) ("Focusing on the presence or absence of congressionally-prescribed legal consequences . . . makes sense as a guide to congressional intent . . . "). According to Merrill & Watts, if Congress specified in the specified in the statute that a violation of agency rules would subject the offending party to some sanction—a civil or criminal penalty; loss of a permit, license, or benefits; or other adverse legal consequences—then the grant conferred power to make rules with the force of law. *Id.*

The presence or absence of statutory penalties for noncompliance is not necessarily the *sine qua non* for concluding that agency legal pronouncements carry or lack the force of law. Merrill & Watts acknowledged that contemporary courts at times have concluded that agency rules carry the force of law notwithstanding their lack of statutory sanctions. *See id.* at 473-74. Conversely, *Mead* itself denied *Chevron* deference to individualized tariff ruling letters with which the recipients were required to comply if they wanted to bring their goods into the United States. *See Mead*, 533 U.S. at 222-23 (describing the legal status of tariff ruling letters). In other words, courts may sometimes conclude that an agency rule that lacks statutory sanctions nevertheless carries the force of law, or that an informal adjudication with a limited coercive range does not carry legal force. But it seems the coupling of an exercise of statutory rulemaking power with statutory penalties represents the paradigmatic example of an agency action that carries the force of law.

### B. The Government Has Analogized Revenue Rulings To Treasury Regulations In Arguing For *Chevron* Deference In Past Cases

Although it has not made this argument in the litigation at bar, the government has analogized revenue rulings to Treasury regulations and claimed *Chevron* deference in several post-*Mead* cases. *See, e.g.*, Brief for the Appellee at 60, *Conopco, Inc. v. United States*, No. 073564 (3d Cir. May 7, 2008), 2008 WL 4126843; Brief for the Appellant at 39-40, *U.S.A.*

*Choice Internet Serv., LLC v. United States*, No. 2007-5077 (Fed. Cir. June 13, 2007), 2007 WL 1997157; Brief for the Appellant at 28, *Texaco Inc. v. United States*, No. 06-16098 (9th Cir. Sept. 29, 2006), 2006 WL 3623262; Brief for Defendant-Appellant at 42-43, *Fortis, Inc. v. United States*, No. 05-2518 (2d Cir. Nov. 21, 2005), 2005 WL 5280992.

A few months after the Court concluded in *Mayo Foundation for Medical Education and Research v. United States*, 131 S. Ct. 704 (2011), that Treasury regulations were entitled to *Chevron* deference, the government publicly signaled its intent to stop seeking *Chevron* deference for revenue rulings. *See* Marie Sapirie, *ABA Section of Taxation Meeting: DOJ Won't Argue for* Chevron *Deference for Revenue Rulings*, 131 Tax Notes 674 (2011). Nevertheless, revenue rulings have not changed during that time, so the government's arguments in those cases are worth noting.

To support its claim for *Chevron* deference for revenue rulings, the government identified several ways in which revenue rulings are analogous to Treasury regulations, including but not limited to their penalty potential. The various briefs in which the government made this argument all read similarly, so to quote one such brief is to paraphrase them all:

> The IRS promulgates Revenue Rulings pursuant to its statutory authority to 'prescribe all needful rules and regulations for the enforcement of the [IRC]. Revenue rulings are formal

> interpretative rulings involving 'substantive tax law.' They are issued by the IRS National Office and published in the Internal Revenue Bulletin as the agency's 'official' position to guide taxpayers and IRS officials alike. Both rulings and regulations are written and reviewed at the same levels of the IRS and the Treasury Department. Like regulations, Revenue Rulings have legal force and effect in that they constitute 'precedents to be used in the disposition of other cases' that 'may be cited and relied upon for that purpose.' And a taxpayer's disregard of applicable Revenue Rulings can result in the imposition of penalties.

Brief for the Appellant at 39-40, *U.S.A. Choice Internet Serv., LLC v. United States*, No. 2007-5077 (Fed. Cir. June 13, 2007), 2007 WL 1997157 (internal citations omitted). In at least one case, the government claimed in at least one case that "the only material distinction" between Treasury regulations and revenue rulings "is that the latter are not issued pursuant to notice-and-comment procedures." Brief for the Appellant at 28, *Texaco Inc. v. United States*, No. 06-16098 (9th Cir. Sept. 29, 2006), 2006 WL 3623262.

## III. THE COURT SHOULD NOT EXTEND *CHEVRON* DEFERENCE TO REVENUE RULINGS BECAUSE THEY VIOLATE APA PROCEDURAL REQUIREMENTS

In light of the penalties associated with failing to comply with revenue rulings, as well as the other ways in which revenue rulings are analogous to Treasury regulations, it seems logical to conclude that like Treasury regulations, revenue rulings carry the force of law for *Mead* and *Chevron*. Yet, revenue rulings are distinguishable from Treasury regulations based on their lack of notice and comment. For that reason, revenue rulings present something of an administrative law conundrum: They contain substantive and legally binding agency rules that seem to carry the force of law, but they lack the procedures that the Administrative Procedure Act requires and courts ordinarily associate with substantive and legally binding agency rules, and they simultaneously lack a good justification for that omission.

### A. Revenue Rulings Violate APA Procedural Requirements

As observed in Part I, when agencies exercise delegated power to adopt rules carrying the force of law, they generally are bound to follow certain procedures mandated by Congress. *See Chrysler Corp. v. Brown*, 441 U.S. 281, 303 (1979). Absent express congressional authorization to the contrary, APA § 553 provides the procedures that govern agency rulemaking. *See* 5 U.S.C. § 553. Specifically, APA § 553 requires agencies adopting rules that

carry the force of law to pursue procedures involving, *inter alia*, public notice and opportunity for comment, thereby "reintroduce[ing] public participation and fairness to affected parties after governmental authority has been delegated to unrepresentative agencies." *American Hospital Ass'n v. Bowen*, 834 F.2d 1037, 1044 (D.C. Cir. 1987) (quoting *Batterton v. Marshall*, 648 F.2d 694, 703 (D.C. Cir. 1980)).

The IRC does not contain any language excusing revenue rulings from APA procedural compliance. APA § 553 recognizes several general exceptions from notice-and-comment rulemaking—for interpretative rules, procedural rules, policy statements, and good cause. *See* 5 U.S.C. § 553(b). The IRS has not asserted good cause for dispensing with notice and comment with respect to any of the revenue rulings cited by the government in this case, or any other revenue rulings for that matter. Therefore, of the exceptions listed by the APA, the only one remotely apt to revenue rulings would seem to be that for interpretative rule. *See, e.g.*, Brief for the Appellee, *AMMEX, Inc. v. United States*, No. 03-5107 (Fed. Cir. Oct. 9, 2003), 2003 WL 24305581 at *40 (describing revenue ruling as a "formal interpretative rule" even while asserting that it carries the force of law for *Mead* and *Chevron*). Courts evaluating particularly whether agency rules are eligible for the interpretative rule exception often ask whether the rules in question carry the force of law. *See, e.g., American Mining Congress v. Mine Safety & Health Admin.*, 995 F.2d 1106, 1109 (D.C. Cir. 1993) ("We have said that a rule has such force only if Congress has delegated legislative power to

the agency and if the agency intended to exercise that power in promulgating the rule.").

If, as argued, revenue rulings carry the force of law for *Mead* and *Chevron*, then can they be said not to carry the force of law for the APA § 553 interpretative rule exception? Imagining such an argument is difficult.

### B. Agency Formats That Systematically Violate APA Procedural Requirements Are Unreasonable

Just as the courts have linked APA procedural compliance with the force of law, correspondingly, the Court in *Mead* recognized a linkage between procedure and *Chevron* deference. "It is fair to assume generally that Congress contemplates administrative action with the effect of law when it provides for a relatively formal administrative procedure tending to foster the fairness and deliberation that should underlie a pronouncement of such force." *Mead*, 533 U.S. at 230. "Thus," the Court noted, "the overwhelming number of our cases applying *Chevron* deference have reviewed the fruits of notice-and-comment rulemaking or formal adjudication." *Id.* Nevertheless, the *Mead* Court went on to say that public notice and opportunity for comment are not required for a rule to be *Chevron* eligible. *See United States v. Mead Corp.*, 533 U.S. 218, 226-27, 230-31 (2001). Subsequently, in *Barnhart v. Walton*, 535 U.S. 212 (2002), the Court suggested that *Chevron* deference would be appropriate for "longstanding" agency interpretations

reached through "means less formal than 'notice and comment' rulemaking," like the one at bar. *Id.* at 221-22.

Notwithstanding the *Barnhart* Court's statement, the Social Security Administration rule at issue in that case had been promulgated using APA notice-and-comment rulemaking. *Id.* at 217. Indeed, at least since deciding *Mead*, the Court has not actually extended *Chevron* deference to an agency rule that lacks notice and comment.

The Court's caveat in *Mead* remains consistent with the standard articulated therein of looking to whether agency action carries the force of law—in the rulemaking context, specifically because Congress on occasion authorizes agencies to adopt legally binding rules without the benefit of notice and comment procedures. Congress did so through the APA, exempting otherwise binding rules from notice and comment when the agency contemporaneously finds and documents "that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest." 5 U.S.C. § 553(b). Congress similarly authorized interim final rules with only post-promulgation notice and comment in the Federal Aviation Reauthorization Act, *see* 49 U.S.C. § 45301(b)(2), and the Health Care Portability and Accountability Act, *see* 26 U.S.C. § 9833. Again, revenue rulings enjoy no such statutory exemption from APA notice-and-comment rulemaking requirements.

While *Mead*'s two steps, by themselves, would seem to suggest that revenue rulings are eligible for

*Chevron* deference, and revenue rulings' lack of notice and comment is not an absolute barrier to *Chevron* review, *Mead* does not and should not exist in a vacuum. Rather, courts and scholars generally recognize a closer connection between *Chevron* deference and other APA requirements.

For example, the Court has indicated that process review under *Motor Vehicle Manufacturers Association of United States, Inc. v. State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29 (1983), and *Chevron*'s reasonableness inquiry are "the same" because both represent variations of the arbitrary and capricious standard of APA § 706(2)(A). *See Judulang v. Holder*, 132 S. Ct. 476, 483 n.7 (2011); *see also, e.g., National Ass'n of Regulatory Utility Comm'rs v. ICC*, 41 F3d 721 (D.C. Cir. 1994) (noting that "the inquiry at the second step of Chevron overlaps analytically with a court's task under the [APA] . in determining whether agency action is arbitrary and capricious (unreasonable)"); Ronald M. Levin, *The Anatomy of* Chevron*: Step Two Reconsidered*, 72 Chi-Kent L. Rev. 1253, 1285-86 (1997) (advocating a merger of *Chevron* step two and process review under *State Farm* based on analysis of D.C. Circuit jurisprudence).

APA § 706(2)(D) specifically instructs reviewing courts to invalidate regulations that fail to comply with statutory procedures. But APA § 706(2)(A) correspondingly compels reviewing courts to set aside regulations found to be "arbitrary, capricious, an abuse of discretion, *or otherwise not in accordance with law*." 5 U.S.C. § 706(2)(A) (emphasis added). Failing to comply with congressionally-

mandated procedural requirements, whether found in APA § 553 or elsewhere, is obviously not in accordance with law. Consistent with this reasoning, in a case that raised questions regarding the procedural validity of a Treasury regulation, the Fifth Circuit suggested that a failure to comply with the requirements of APA § 553 might mean that the regulation should be denied *Chevron* deference. *See Burks v. United States*, 633 F.3d 347, 360-61 n.9 (5th Cir. 2011); *see also* Kristin E. Hickman, *Unpacking the Force of Law*, 66 Vand. L. Rev. 465, 540-42 (2013) (extending this argument).

### C. *Skidmore* Review Is Not A Remedy

Rather than invalidating all revenue rulings as unreasonable under *Chevron*, the Court may be tempted instead to throw up its hands at the mess surrounding revenue rulings and call for *Skidmore* review as a means of achieving rough justice. After all, the case at bar involves a longstanding and official IRS interpretation that the taxpayers arguably knew or should have known applied to their facts and circumstances. In such a case, *Skidmore* review would seem to be ideal. This approach would be flawed for two reasons.

First, employing *Skidmore* rather than *Chevron* review would conflate a standard of review with a remedy. Based on the above analysis, the problem that revenue rulings pose is not that they carry the force of law and are entitled to *Chevron* deference, or that they lack the force of law and are eligible only for *Skidmore* respect. Rather, revenue rulings' flaw is their lack of public notice and

opportunity for comment after Treasury and IRS decided to promulgate regulations pulling revenue rulings within the ambit of the IRC's penalty provisions. A less deferential standard of review is not a traditional remedy for procedurally invalid agency rules. *See* 3 Charles H. Koch, Jr., Administrative Law and Practice §§ 8:30-8:35 (3d ed. 2010) (surveying remedies in administrative law cases).

Second, extending *Skidmore* review to revenue rulings would not be doctrinally sound. As argued extensively herein, the Court's jurisprudence firmly associates *Chevron* deference with congressional delegation and agency actions that carry the force of law. Given the characteristics that revenue rulings exhibit, beginning but by no means ending with their penalty potential, concluding that they lack the force of law would undermine that association, and thus the very premise of *Mead*. By contrast, invalidating all revenue rulings as unreasonable under *Chevron* step two would achieve an arguably similar end, but through a more doctrinally consistent means. Under *Skidmore* review, the Court rather than the agency becomes the primary interpreter of the law. *See Skidmore*, 323 U.S. at 140 (describing informal rulings as "not controlling upon the courts"). In the absence of a valid revenue ruling driving the outcome of the case, the Court would find itself in much the same position—interpreting the IRC de novo—but through reasoning more consistent with its precedents concerning *Mead*, *Chevron*, the APA, and the force of law.

## CONCLUSION

The standard of review for revenue rulings is a jurisprudential mess with no easy or clean resolution. Yet, ultimately, the fault for the difficulty lies with the government. With revenue rulings, Treasury and the IRS have tried to have their cake and eat it, too. They enjoy the ease and flexibility of revenue rulings as informal guidance, yet they want taxpayers to feel legally bound to follow the legal interpretations contained within. Treasury and the IRS imposed penalties for noncompliance with revenue rulings, yet they refuse to subject the interpretations that revenue rulings advance to notice-and-comment rulemaking.

Even though the case at bar is a refund action with no penalty potential, so avoids the worst aspect of revenue rulings, the standard of review issue reaches far beyond this case. The circumstances surrounding revenue rulings are legally untenable and damaging to the integrity of the tax system.

Respectfully submitted.

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